84-1745

No.

Office-Supreme Court, U.S.
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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

WILLIAM J. SCHILLING, Individually and as COMMISSIONER OF SAVINGS AND LOAN ASSOCIATIONS FOR THE STATE OF ILLINOIS,

Petitioner,

VS.

TELEGRAPH SAVINGS AND LOAN ASSOCIATION OF CHICAGO and the OFFICERS and DIRECTORS thereof,

Respondents.

APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ILLINOIS

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APPENDIX A

[*Letterhead of*]
ILLINOIS SUPREME COURT
JULEANN HORNYAK, CLERK
SUPREME COURT BUILDING
SPRINGFIELD, ILL. 62706
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February 1, 1985

Hon. Neil F. Hartigan
Attorney General
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Chicago, IL 60601

No. 59149—Telegraph Savings and Loan Association of Chicago, et al., appellees, v. William J. Schilling, Indv., etc., appellant. Appeal, Appellate Court, First District.

The Supreme Court today *DENIED* the petition for rehearing in the above entitled cause.

The mandate of this Court will issue to the appropriate Appellate Court, Circuit Court or other Agency on February 8, 1985.

APPENDIX B

[Filed November 30, 1984]

IN THE
SUPREME COURT OF ILLINOIS

Docket No. 59149—Agenda 41—September 1984.

TELEGRAPH SAVINGS & LOAN ASSOCIATION OF CHICAGO *et al.*, Appellees, v. WILLIAM J. SCHILLING, Indiv. and as Commissioner of Savings and Loan Associations, Appellant.

JUSTICE MORAN delivered the opinion of the Court:

Plaintiffs, Telegraph Savings and Loan Association of Chicago and the officers and directors thereof (collectively referred to as Telegraph), filed a complaint in the circuit court of Cook County against defendant, William J. Schilling, individually and as Commissioner of Savings and Loan Associations for the State of Illinois (Commissioner). Telegraph challenged the Commissioner's closing of the Association without advance written notice or a valid finding of an "emergency" situation which would excuse the advance-written-notice requirement (Ill. Rev. Stat. 1979, ch. 32, par. 848, now Ill. Rev. Stat. 1983, ch. 17, par. 3191). The Commissioner filed a motion to dismiss the action, which was granted. Telegraph appealed from the order of the circuit court, which dismissed the action against the Commissioner with prejudice. The appellate court reversed the dismissal order and remanded for further proceedings. (115 Ill. App. 3d 331.) We allowed the Commissioner's petition for leave to appeal (87 Ill. 2d R. 315(a)).

The central issue raised on appeal is whether Telegraph is entitled to a State court determination of the State-law "emergency" issue raised in its complaint.

The general background information necessary for an understanding of the issue is disclosed in the Seventh Circuit Court of Appeals opinion, *Telegraph Savings & Loan Association v. Schilling* (7th Cir. 1983), 703 F.2d 1019. In the late 1970's, Telegraph, an Illinois chartered savings and loan association, failed to meet the reserve and

net worth minimums required by 12 C.F.R. section 563.13 (1980). As such, State and Federal officials responsible for the regulation of savings and loan associations met to analyze the source of Telegraph's financial difficulties. It was concluded that undercapitalization was responsible for Telegraph's financial decline. At this time, the Commissioner indicated that the State would be forced to assume custody if the situation were not remedied.

Telegraph's financial condition was the subject of subsequent meetings held in 1979 and 1980. A take-over plan was devised which involved the joint efforts of the Commissioner, the Federal Home Loan Bank Board (FHLBB), and the Federal Savings and Loan Insurance Corporation (FSLIC).

The record reveals that on May 22, 1980, the Commissioner took custody of Telegraph pursuant to section 7-8 of the Illinois Savings and Loan Act (Act) (Ill. Rev. Stat. 1979, ch. 32, par. 848). Section 7-8(e) provides in relevant part:

> "Unless the Commissioner finds that an emergency exists which may result in loss to members or creditors and requires that he take custody immediately, he first shall give written notice to the directors, trustees, or liquidators specifying the conditions criticized and state a reasonable time within which correction may be made."

The Commissioner did not give advance written notice of intent to take custody. Rather, he appeared at Telegraph's offices on the day of the seizure with a document entitled "NOTICE OF TAKING CUSTODY OF TELEGRAPH SAVINGS AND LOAN ASSOCIATION OF CHICAGO." This notice states that the Commissioner had made a finding that the withdrawable and permanent reserve capital of Telegraph were impaired, creating an emergency situation and necessitating immediate custody by the Commissioner.

Almost immediately after the Commissioner presented Telegraph's president with the notice, the FHLBB appointed the FSLIC as receiver of Telegraph, pursuant to 12 U.S.C. section 1729(c)(2) (1976). The FSLIC immediate-

ly transferred Telegraph's assets to First Federal Savings and Loan Association under a purchase and assumption agreement.

In the instant appeal, the Commissioner has raised several issues for review by this court. Before we reach those issues, we must address an issue raised by Telegraph. It argues that this court lacks jurisdiction because the Commissioner failed to file his petition for leave to appeal within 35 days after the entry of the judgment appealed from, as mandated by Supreme Court Rule 315(b) (87 Ill. 2d R. 315(b)). Rule 315(b) provides, on motion, for an extension of time for petitioning for leave to appeal. While the rule expressly states that "such motions are not favored and will be allowed only in the most extreme and compelling circumstances," this court, nonetheless, granted the Commissioner's motion based on the circumstances set forth therein. Accordingly, Telegraph's argument is without merit.

Because we find that this court does have jurisdiction, we turn to the arguments raised by the Commissioner. Initially he contends that Telegraph lacks capacity to maintain this action. In support of this contention he relies on 12 C.F.R. section 569a.4 (1980). Pursuant to this Federal regulation, the FSLIC, as receiver, succeeds to "all the rights, titles, powers and privileges of the insured institution * * * [as well as those of] its officers and directors * * *." Further, under the regulation, the officers and directors of the seized institution "shall not thereafter have or exercise any such rights, powers, or privileges or act in connection with any asset or property of any nature of the institution in receivership." As such, it is the Commissioner's position that Telegraph is precluded from prosecuting this action because "all property rights, including choses in action have been vested in the FSLIC."

The Commissioner cites three Federal cases which, he contends, adopt this position. (*First Savings & Loan Association v. First Federal Savings & Loan Association* (D. Hawaii 1981), 531 F. Supp. 251; *First Savings & Loan Association v. First Federal Savings & Loan Association* (D. Hawaii 1982), 547 F. Supp. 988; *Manning Savings &*

Loan Association v. FSLIC (N.D. Ill. Sept. 14, 1983), No. 83-C-757.) The Commissioner's reliance on these cases is misplaced. It is true that these cases expressly recognize that the FSLIC acquires all powers necessary to administer the operations of a seized institution pursuant to the regulations (12 C.F.R. sec. 569a.4 (1980)) promulgated under 12 U.S.C. section 1729(d) (1976). This includes the power to represent the institution in any legal action. (12 C.F.R. sec. 569a.6(a)(2-3) (1980).) At the same time, however, these cases acknowledge the limited right of an association to challenge the appointment of a receiver pursuant to 12 U.S.C. section 1464(d)(6)(A) (1976). The Illinois Savings and Loan Act contains similar provisions. Thus, pursuant to section 7-10 of the Act, the Commissioner, if he takes custody of an association, succeeds to "all powers necessary to accomplish the purposes of custody, including (but not limited to) the powers, privileges and authority previously vested in the officers, directors, liquidators or trustees * * *." (Ill. Rev. Stat. 1979, ch. 32, par. 850, now Ill. Rev. Stat. 1983, ch. 17, par. 3193.) In a provision analogous to 12 U.S.C. section 1464(d)(6)(A) (1976), section 7-12 of the Act expressly authorizes a challenge to the Commissioner's custodial action. Section 7-12 provides:

> "Immediately upon taking custody of an association or trust, the Commissioner shall mail a written notice thereof to the president or secretary and not less than 2 directors of such association, or to 2 or more of the trustees of any trust, or 2 or more of the liquidators of an association in liquidation. If the contention is made that the Commissioner has no legal grounds for taking custody of the association or trust, the directors or officers of the association or the trustees or liquidators thereof, as the case may be, at any time within 10 days after the mailing of such notice, or within such further periods of time as the Commissioner may extend, but not to exceed an additional 60 days, may file a complaint in the Circuit Court of Sangamon County, Illinois or in the Circuit Court of the county in which the association is

located, to enjoin further custody. The court thereupon shall cite the Commissioner to show cause why further custody should not be enjoined. If upon a hearing thereon, the court finds that such grounds did not or do not then exist, it may enter an appropriate order in accordance with the findings of fact, or an order enjoining the Commissioner or any appointees acting under his direction from further custody." Ill. Rev. Stat. 1979, ch. 32, par. 852, now Ill. Rev. Stat. 1983, ch. 17, par. 3195.

The powers granted to the Federal receiver, pursuant to the Federal regulation, and the Commissioner pursuant to section 7-10 of the Act are merely the administrative powers necessary for the receiver to conduct the business operations of the seized institution. The bestowal of such powers does not deprive the seized institution of its statutory right to challenge the Commissioner's original takeover. The clear language of the statute indicates otherwise. Thus, by bringing its State action pursuant to section 7-12 of the Act, Telegraph was merely exercising its statutory right to judicial review of the Commissioner's actions. Furthermore, as Telegraph correctly observes, this court has previously stated "that if the legislature did not accord the right to obtain judicial review and control of the [Commissioner's] conduct the Savings and Loan Act would be constitutionally suspect. [Citations.]" *Mensik v. Smith* (1960), 18 Ill. 2d 572, 586.

The Commissioner further argues that the resolution of Telegraph's claims in Federal court, under 12 U.S.C. section 1464(d)(6)(A) (1976), operates as a bar to the State action. Applying the doctrine of collateral estoppel, the Commissioner argues that the findings of fact made by the Federal court, pursuant to Telegraph's attempt to remove the FSLIC as receiver, demonstrate that his actions were reasonable. As such, Telegraph is estopped from attacking that conduct. The resolution of this argument necessitates a recitation of the chronological course this controversy has taken in both State and Federal courts.

On June 2, 1980, Telegraph filed lawsuits in the circuit court of Cook County (No. 80-CH-3860) and the United States District Court for the Northern District of Illinois (No. 80-C-2792) (original Federal action). The original Federal action involved a determination of whether the statutory requirements for the appointment of an FSLIC receivership had been satisfied. (12 U.S.C. sec. 1729(c)(2) (1976).) In both the State and Federal actions, Telegraph sued the Commissioner, as well as the FHLBB and the FSLIC. Upon petition of the Federal defendants, the State action was removed to Federal court (No. 80-C-2782) (removed Federal action). The removed Federal action was dismissed, on June 12, 1980, for lack of derivative jurisdiction. The court refused to remand the State-law claim against the Commissioner. It found that the State "emergency" issue was "part and parcel" of the claim against the FSLIC and FHLBB, over which the State court had no jurisdiction. The same day that the removed Federal action was dismissed, therefore, Telegraph filed a new State court action (No. 80-CH-4170). This new State action, which is the subject of the instant appeal, named only the Commissioner as a defendant, bringing the action pursuant to section 7-12 of the Act (Ill. Rev. Stat. 1979, ch. 32, par. 852).

Telegraph, by its complaint filed in State court on June 12, 1980, contended that "no emergency existed with respect to [the Association] and further the Commissioner did not purport to make a valid finding that such an emergency existed." As such, Telegraph maintained that the Commissioner acted in abuse of his discretion by taking custody of the Association without advance written notice. (Ill. Rev. Stat. 1979, ch. 32, par. 848.) Accordingly, injunctive and declaratory relief were sought.

The Commissioner's motion to dismiss was granted by the trial court. The transcript from the hearing on that motion indicates that the trial court, relying on the June 12 dismissal of the removed Federal action, found that the Federal court had assumed jurisdiction on the merits of the case. In addition, the court concluded that injunctive relief was no longer possible under the circumstances

of the case. Finally, it indicated that if an action were sustained in the State court, the action would be in damages. The judge, however, declined to grant Telegraph's oral motion to transfer the complaint to the law division.

At this point, therefore, Telegraph was limited to its original Federal action (No. 80-C-2792) wherein State and Federal statutory violations were asserted. This action was ultimately resolved in favor of the Federal defendants. The Federal court, however, refused to consider the State-law claim. In a February 19, 1982, order for a status hearing, the district court indicated that it was of the opinion that it should refuse to exercise pendent jurisdiction over the State-law claims since they involved "difficult questions of state law which are of first impression." (*Telegraph Savings & Loan Association v. Federal Savings & Loan Insurance Corp.* (N.D. Ill. 1982), 564 F. Supp. 880 (order for status hearing).) Further, in an order dated March 18, 1982, the district court found that the State counts involve "novel questions of state statutory construction which are neither addressed nor resolved" by the findings of the district court on the other counts. (*Telegraph Savings & Loan Association v. Federal Savings & Loan Insurance Corp.* (N.D. Ill. March 18, 1982), No. 80-C-2791.) As such, it dismissed the State-law issues without prejudice. Finally, in the Seventh Circuit opinion the court concluded:

> "The fact that [the district court] dismissed the separately pleaded state law counts without prejudice merely indicates that these claims are independent of Telegraph's challenge to a federal receivership under federal law. The dismissal cannot be read as a ruling on the validity of the state claims." *Telegraph Savings & Loan Association v. Schilling* (7th Cir. 1983), 703 F.2d 1019, 1029-30.

Because the Federal court refused to assert pendent jurisdiction over the counts based entirely on State law, and dismissed the claims without prejudice for lack of jurisdiction, the appellate court, in the instant case, determined that Telegraph was entitled to a State-court adjudication of those issues. Accordingly it reversed the circuit court's dismissal of the action, stating:

> "Whatever the binding effect of the opinion of the Court of Appeals [Seventh Circuit] may be on certain facets of the litigation, it does not necessarily foreclose a finding by the State court of a lack of an emergency. * * * Telegraph has a right to have its State law claims resolved in a State court." 115 Ill. App. 3d 331, 340.

We agree.

The doctrine of collateral estoppel has been defined by this court as applying "when a party or someone in privity with a party participates in two separate and consecutive cases arising on *different* causes of action and some controlling fact or question material to the determination of both causes has been adjudicated against that party in the former suit by a court of competent jurisdiction. [Citation.] The adjudication of the fact or question 'in the first cause will, if properly presented be conclusive of the same question in the later suit' [citation], but 'the judgment in the first suit operates as an estoppel only as to the point or question *actually litigated* and determined and not as to other matters which might have been litigated and determined.' " (Emphasis in original.) (*Housing Authority v. Young Men's Christian Association* (1984), 101 Ill. 2d 246, 252.) When determining whether the doctrine of collateral estoppel precludes the resolution of the State-law claim, therefore, the only relevant inquiry is whether the Federal court decided that an emergency existed. We need not speculate as to whether the factual inquiry regarding the State "emergency" issue was ever resolved by the Federal courts. The Federal district court, as well as the Seventh Circuit court, expressly recognized that the State-law claims were distinct from Telegraph's challenge of the Federal receivership and declined to address the State claims. If follows, therefore, that the doctrine of collateral estoppel will not act as a bar to a State court adjudication of the emergency issue.

In the third issue raised by the Commissioner, he maintains that Telegraph's complaint fails to state a cause of action under section 7-12 of the Act (Ill. Rev. Stat. 1979,

ch. 32, par. 852). The complaint filed on June 2, 1980, named only Telegraph, the association, as plaintiff. The statute authorizes a suit to be filed against the Commissioner by "the directors or officers of the association or the trustees or liquidators thereof * * *." As such, the Commissioner maintains that Telegraph lacks standing to sue pursuant to section 7-12 of the Act. While the suit filed on June 12, 1980, named the officers and directors of Telegraph, as well as the association, as party plaintiffs, this action was filed past the 10-day period (custody occurred on May 22, 1980) mandated by section 7-12 of the Act. Thus, the Commissioner contends, the officers and directors, the only proper party plaintiffs, failed to timely seek relief. We do not agree.

Telegraph's complaint, filed June 2, 1980 (No. 80-CH-3860), while brought only in the name of the Association, was filed within the 10-day period required by section 7-12 of the Act. When this action was removed to Federal district court (No. 80-C-2782), through no fault of Telegraph but upon petition of the Federal defendants, the time for filing an action challenging the Commissioner's actions was tolled. Thus, when Telegraph filed the instant State action (No. 80-CH-4170) on June 12, 1980, the very day the removed Federal action was dismissed, it was as if Telegraph was filing on the 10th day following the take-over.

Further the 10-day limitation period mandated by section 7-12 should be analyzed in view of its purpose. As succinctly stated in a 1954 decision of this court:

> "The basic policy of [statutes of limitation] is to afford a defendant a fair opportunity to investigate the circumstances upon which liability against him is predicated while the facts are accessible. * * * As observed by Mr. Justice Holmes in *New York Central Railroad v. Kinney*, 260 U.S. 340, 342, 'Of course an argument can be made on the other side, but when a defendant has had notice from the beginning that the plaintiff sets up and is trying to enforce a claim against it because of specified conduct, the reasons for the statute of limitations do not exist, and we are of opinion that a liberal rule should be ap-

plied.' " (*Geneva Construction Co. v. Martin Transfer & Storage Co.* (1954), 4 Ill. 2d 273, 289-90.)

Under the circumstances of the instant case, we find that the objective of the 10-day limitation period of section 7-12 of the Act has been fully served.

Finally, the Commissioner argues that the appellate court erred in finding that the issue of damages was not waived by Telegraph. While conceding that injunctive relief was not viable, because the Commissioner no longer had custody of Telegraph, the appellate court concluded that Telegraph was not necessarily barred from relief. Section 7-12 of the Act, in addition to providing for injunctive relief, provides in relevant part: "If upon a hearing thereon, the court finds that such grounds [for taking custody] did not or do not then exist, it may enter an appropriate order * * *." (Ill. Rev. Stat. 1979, ch. 32, par. 852.) The court found that this provision "may give a right to damages." (115 Ill. App. 3d 331, 340.) The court cited the Seventh Circuit opinion, *Telegraph Savings & Loan Association v. Schilling* (7th Cir. 1983), 703 F.2d 1019, which also recognized the possible right to damages. In a footnote in the Seventh Circuit opinion, the court observed:

> "Although it held that the federal appointment could not be challenged under state law, the district court [564 F. Supp. 862, 880] noted that if either the state or federal authorities violated state law, Telegraph may have an action for damages under Illinois law, Ill. Rev. Stat. ch. 32, sec. 852, or under federal law, 42 U.S.C. sec. 1983." 703 F.2d 1019, 1024 n.4.

Further, the appellate court, in the instant case, held that Telegraph had not waived its right to such relief because it failed to specifically seek damages or submit a proposed amendment. Telegraph made two general requests to amend its complaint, in a reply to the Commissioner's brief in support of his motion to dismiss and orally during the hearing on the motion to dismiss. During that hearing, the court noted "that if an action were sustained in the State Court the action would be in damages." In addition, the court stated "that if the suit was sustain-

able in the Circuit Court at the present time it would be a matter for the Law Division rather than for the Chancery Division." Nevertheless, the court denied Telegraph's oral motion to transfer the action to the law division and granted the motion to dismiss.

Section 34 of the Civil Practice Act (Ill. Rev. Stat. 1979, ch. 110, par. 34) provides that "the prayer for relief does not limit the relief obtainable" except in the case of default judgments and cases involving prejudice to the adverse party by reason of surprise. " 'Courts may disregard labels, and may grant relief to which a plaintiff is entitled upon the evidence.' " (*Nugent v. Collins* (1980), 89 Ill. App. 3d 874, 879.) It would seem that the same discretion would be allowed to a reviewing court when reversing and remanding a cause previously dismissed. Based on the pleadings and in light of Telegraph's two requests to amend as well as the judicial commentary on the possible right to damages, we do not find that the Commissioner will be prejudiced by allowing Telegraph to amend its complaint on remand. Accordingly, we find that the appellate court did not err in affording Telegraph "the opportunity to move to amend [on remand] to specifically seek damages and to transfer the cause to the law division." 115 Ill. App. 3d 331, 341.

For the reasons stated herein, the judgment of the appellate court reversing the dismissal of the circuit court and remanding for further proceedings, is affirmed.

Judgment affirmed.

JUSTICE UNDERWOOD, dissenting:

I do not share my colleagues' opinion that the doctrine of collateral estoppel is inapplicable here, nor do I believe that an action for damages is permissible in these circumstances.

The majority cites section 7-12 of the Illinois Savings and Loan Act (Ill. Rev. Stat. 1979, ch. 32, par. 852, now Ill. Rev. Stat. 1983, ch. 17, par. 3195) to support its conclusion that Telegraph could proceed with a State court action for damages. However, that section, which is en-

titled in part "Notice of Custody—Action to *Enjoin*" (emphasis added), provides:

> "* * * If the contention is made that the Commissioner has no legal grounds for taking custody of the association or trust, the directors or officers of the association or the trustees * * * may file a complaint * * * to *enjoin* further custody. The court thereupon shall cite the Commissioner to show cause why further custody should not be *enjoined*. If upon a hearing thereon, the court finds that such grounds did not or do not then exist, it may enter an appropriate order in accordance with the findings of fact * * *." (Emphasis added.)

It seems to me that this provision unambiguously limits the plaintiff association to injunctive relief. There is simply nothing to suggest that damages are recoverable. The term "appropriate order," emphasized by the majority, obviously refers to the provisions of an order granting or denying the injunction, as that is the only purpose of the hearing. Too, if the General Assembly had intended to provide for damages in these circumstances, it seems likely that it would have explicitly stated so, for "[t]he body of the statute cannot encompass a broader subject than is stated in the title." *People v. Tibbitts* (1973), 56 Ill. 2d 56, 64; 1A Sutherland, Statutory Construction sec. 18.01 *et seq.* (4th ed. 1972).

However, even if I were to concede that damages are recoverable under section 7-12, the Federal court proceedings involved here would, in my judgment, bar Telegraph's State court action on collateral estoppel grounds. As the majority points out, to prevail in its suit for damages Telegraph must prove that no "emergency" existed which could have justified the Commissioner's taking custody of the institution without written notice. Although the Illinois Savings and Loan Act does not specify what constitutes an "emergency," the Federal district court found that Telegraph was on the brink of financial collapse and that the take-over was imperative to safeguard the depositors' funds. The court noted:

> "From July 1, 1979, to April 30, 1980, Telegraph's book net worth steadily declined from nearly $5 million to $450,000.00. The operational losses for April 1980 alone exceeded $734,000.00. On May 19, Telegraph's comptroller made the following projection:
>
> 'Based upon my review of the books and records of Telegraph as of May 19, 1980 and taking into consideration my knowledge of the financial circumstances of Telegraph, I estimate that for the period May 1 through 19, 1980, Telegraph had lost $591,778.29 and I projected that for the entire month of May, Telegraph would lose $983,147.86.' [citation.] On the basis of the projections of Telegraph's own comptroller, Telegraph had a negative book net worth of approximately $142,000.00 on May 19 and of approximately $240,000.00 on May 22." (*Telegraph Savings & Loan Association v. Federal Savings & Loan Insurance Corp.* (N.D. Ill. 1982), 564 F. Supp. 880, 888-89.)

In addition, the Seventh Circuit Court of Appeals observed that "[t]he evidence overwhelmingly establishes that Telegraph was in precarious financial condition and was continuing to decline." *Telegraph Savings & Loan Association v. Schilling* (7th Cir. 1983), 703 F.2d 1019, 1025.

Curiously, the majority apparently does not believe these findings would be binding or relevant in a State court proceeding aimed at determining Telegraph's financial status. Of course, to actually recover damages Telegraph will also have to show that it has suffered some loss that can be monetarily compensated. Should our courts also disregard the Federal findings on that issue? I think it is abundantly clear that any State court proceeding will involve precisely the same factual issues that have already been resolved by the Federal courts. In fact, a more appropriate case for application of the collateral estoppel doctrine is difficult to imagine.

I would accordingly reverse the judgment of the appellate court and affirm the judgment of the circuit court of Cook County.

RYAN, C.J., and SIMON, J., join in this dissent.

JUSTICE SIMON, also dissenting:

While I join Justice Underwood's disagreement with the majority's decision to allow an additional trial for Telegraph, I would like to point to other areas of dissatisfaction I have with the majority opinion. First, I agree with Justice Underwood's analysis of the collateral-estoppel issue, which requires a complete bar of a trial at the State level. Even if the majority view that the dismissal of the State-law counts indicates that these are claims independent of the Federal action is accepted, I do not believe the circuit court has a free hand at this new trial to allow adjudication of all facts relating to whether an emergency situation existed at the time of the takeover. Collateral estoppel acts as a bar to relitigation of "controlling fact[s] or question[s] material to determination" of the causes of action brought by the same party. (Slip op. at 7, citing *Housing Authority v. Young Men's Christian Association* (1984), 101 Ill. 2d 246, 252.) It is clear to me that the factual determinations of the Federal courts concerning the financial stability of Telegraph at the time of the takeover cannot be relitigated, even accepting the majority's allowance of another trial which deals exclusively with the emergency issue. Instead, all factual issues relevant to the emergency question may have already been established at the trial in the United States district court. All that would be left for the circuit court, if anything, would be the legal judgment of whether these facts constituted an emergency situation under the statute. While I feel an emergency existed, I do not believe the majority opinion allows for anything more than this limited inquiry.

Second, I agree with Justice Underwood's judgment that no damages are contemplated by section 7-12 of the Illinois Savings and Loan Act (Ill. Rev. Stat. 1979, ch. 32, par. 852, now Ill. Rev. Stat. 1983, ch. 17, par. 3195). I also believe that this question has been left open by the majority for a later determination by the circuit court. The majority has only afforded Telegraph the opportunity to amend its complaint and seek damages. While I believe this result is incorrect, the majority opinion does

not foreclose a finding by the circuit court that an action for damages is improper.

Moreover, the damage issue involves numerous issues, as yet unexplored, which may immunize the defendant with regard to his actions as commissioner. For example, the defendant should not be personally liable for an inadvertent technical violation of the statute. Instead, a showing of bad faith or a wilful violation of the statute's requirements would be necessary. See Ill. Rev. Stat. 1979, ch. 85, par. 1-101 *et seq.*

Finally, I am disturbed by the majority's conclusion because it may lead to future losses to depositors. The savings and loan industry is regulated by both Federal and State authorities. While State regulation is important, the insurance of depositor accounts is provided by the Federal Savings and Loan Insurance Corporation (FSLIC) in conjunction with the Federal Home Loan Bank Board (FHLBB). If our commissioner of savings and loan associations is held personally accountable for this cooperation with the controlling Federal officials, our commissioner may react to this decision in the future by refusing to cooperate with them. Without such cooperation, purchase and assumption transactions like the one negotiated in this takeover will never occur. The result will be forced closings by the FHLBB, and the FSLIC will be required to provide cash payments to individuals only in amounts insured by Federal law. Those investors with more than the insured amount will lose that money instead of retaining the full amount of their savings as happened in the Telegraph situation. This result is unsound and detrimental to those who are savings and loan depositors.

RYAN, C.J., and UNDERWOOD, J., join in this dissent.

APPENDIX C

IN THE
APPELLATE COURT OF ILLINOIS
FIRST JUDICIAL DISTRICT
THIRD DIVISION

80-2153

May 25, 1983

TELEGRAPH SAVINGS & LOAN ASSOCIATION OF CHICAGO and the Officers and Directors thereof,

Plaintiffs-Appellants,

vs.

WILLIAM J. SCHILLING, individually and as Commissioner of Savings and Loan Associations for the State of Illinois,

Defendant-Appellee.

Appeal from the Circuit Court of Cook County.
Honorable George A. Higgins, Judge Presiding

JUSTICE O'CONNOR delivered the opinion of the court:

Plaintiffs, Telegraph Savings & Loan Association of Chicago (Telegraph) and the Officers and Directors thereof, appeal from the order of the circuit court of Cook County dismissing with prejudice their chancery action against defendant, William J. Schilling, individually and as Commissioner of Savings and Loan Associations for the State of Illinois (Commissioner). By their suit, plaintiffs sought relief from defendant for his closing of Telegraph without giving the advance statutory written notice required except where an emergency existed; and without the Commissioner making a finding that an emergency existed.

Section 7-8 of the Illinois Savings and Loan Act (Ill. Rev. Stat. 1981, ch. 17, par. 3191, formerly ch. 32, par.

848) details the Commissioner's authority to take custody of a savings and loan association and concludes:

> "Unless the Commissioner finds that an emergency exists which may result in loss to members or creditors and requires that he take custody immediately, he first shall give written notice to the directors, trustees, or liquidators specifying the conditions criticized and state a reasonable time within which correction may be made."

Section 7-12 of the Illinois Savings and Loan Act (Ill. Rev. Stat. 1981, ch. 17, par. 3195, formerly ch. 32, par. 852) provides:

> "Immediately upon taking custody of an association or trust, the Commissioner shall mail a written notice thereof to the president or secretary and not less than 2 directors of such association, or to 2 or more of the trustees of any trust, or 2 or more of the liquidators of an association in liquidation. If the contention is made that the Commissioner has no legal grounds for taking custody of the association or trust, the directors or officers of the association or the trustees or liquidators thereof, as the case may be, at any time within 10 days after the mailing of such notice, or within such further periods of time as the Commissioner may extend, but not to exceed an additional 60 days, may file a complaint in the Circuit Court of Sangamon County, Illinois or in the Circuit Court of the county in which the association is located, to enjoin further custody. The court thereupon shall cite the Commissioner to show cause why further custody should not be enjoined. If upon a hearing thereon, the court finds that such grounds did not or do not then exist, it may enter an appropriate order in accordance with the findings of fact, or an order enjoining the Commissioner or any appointees acting under his direction from further custody."

Defendant filed a twelve-point motion to dismiss, which was granted. The three grounds stated by the trial court in granting the motion were: (1) the Federal court had

assumed exclusive jurisdiction over the matter; (2) injunctive relief was no longer effective; and (3) the action was sustainable only in the Law Division rather than the Chancery Division.

The factual background of this litigation is stated by the United States Court of Appeals for the Seventh Circuit in its opinion in the consolidated appeals of *Telegraph Savings and Loan Association, et al. vs. William J. Schilling, et al.* (Nos. 80-2012, 82-1635 and 82-1702) and *Telegraph Savings and Loan Association, et al. vs. Federal Savings and Loan Insurance Corporation, Federal Home Loan Bank Board and William J. Schilling* (No. 82-1457) (CA 7), ____ F.2d ____. This opinion was handed down on March 29, 1983, after the oral argument in the case at bar. The court there stated (slip opinion, pp. 2-5):

> "In this appeal Telegraph Savings & Loan Association (Telegraph) challenges its closure by the Illinois Commissioner of Savings and Loan Associations (Commissioner), the appointment of the Federal Savings & Loan Insurance Corporation (FSLIC) as receiver and the subsequent sale of Telegraph's assets to First Federal Savings & Loan Association. The district court held that the takeover and sale were proper. We affirm.
>
> "Telegraph was an Illinois chartered savings and loan association owned by one hundred and twenty stockholders and insured by the FSLIC. In the late 1970's Telegraph began experiencing financial difficulties. As a result of heavy losses, it was unable to satisfy the reserve and net worth minimums required by 12 C.F.R. § 563.13. When Telegraph's financial condition continued to decline at an ever-increasing rate, the state and federal officials charged with regulating savings and loan associations became alarmed. A special meeting was held in October 1979 to identify the cause of Telegraph's decline and to propose some solutions. Telegraph's Board of Directors and representatives of the Commissioner, the FSLIC and the Federal Home Loan Bank Board (FHLBB) attended. At this meeting the Commis-

sioner concluded that undercapitalization was causing Telegraph's shaky financial condition and indicated that, unless this situation was remedied, the state would have to assume custody.

"Additional meetings were held in 1979 and 1980 to monitor Telegraph's financial status and to develop a plan for infusing Telegraph with new capital. Possible mergers were considered but only one concrete plan surfaced. The Heron Corporation offered to purchase 80% of Telegraph's preferred stock if the FSLIC would finance the purchase with a fifteen year interest free loan. The FHLBB vetoed the Heron proposal.

"When no other buyers came forward, the Commissioner and federal officials concluded that they had no choice but to take control. A takeover plan was devised whereby the Commissioner would assume custody of Telegraph and FHLBB would immediately appoint the FSLIC receiver. The FSLIC, in turn, would immediately transfer Telegraph's assets to First Federal Savings & Loan Association under a purchase and assumption agreement.

"According to this prearranged plan, the takeover was effected on May 22, 1981 at Telegraph's main office. Just before the usual closing time the Commissioner served Telegraph's president with a notice that the state was assuming immediate custody. The notice explained that Telegraph's financial instability had created an emergency situation which necessitated the takeover. Telegraph had not received prior written notice of this decision [required, unless an emergency exists, by Ill. Rev. Stat. ch. 32, par. 848, now Ill. Rev. Stat. 1981, ch. 17, par. 3191]. After serving the president with the notice, the Commissioner sent his deputy to the teller's window where one of Telegraph's customers, A. Raymond Bacon, was waiting to withdraw twenty-five dollars. Bacon was making the withdrawal solely because the FHLBB had requested him to do so. When Bacon approached the teller, the deputy intervened. He took the with-

drawal slip from Bacon and handed it, along with an affidavit stating that Bacon had been unable to withdraw his money, to the FHLBB agent. The purchase and assumption agreement was executed immediately and the next day Telegraph's operation opened under First Federal's name.

"Telegraph then filed identical actions challenging the takeover and the appointment of the FSLIC as receiver in the federal court for the Northern District of Illinois and in the state court in the Circuit Court of Cook County. The federal action was assigned to Judge Grady. The state action was removed to federal court and assigned to Judge Marshall. Judge Marshall held that federal courts have exclusive jurisdiction over any action to remove the FSLIC as receiver and concluded that, since the state court never had jurisdiction over the action, it had no authority to remove it to federal court. Declining to grant Telegraph's request to remand back to the state court, Judge Marshall dismissed the action. Telegraph appealed to this court.

"Telegraph also filed a new state court action, this time proceeding against the Commissioner but not the federal agencies. The state court, relying on Judge Marshall's opinion that federal courts have exclusive jurisdiction, dismissed that action. Telegraph appealed this dismissal; that appeal is currently pending in the state court.

"The central issue in the case proceeding before Judge Grady was whether the requirements for appointment of an FSLIC receivership, set forth in 12 U.S.C. § 1729(c)(2) had been satisfied. Section 1729(c)(2) provides that the FHLBB has the authority to appoint the FSLIC receiver over a state savings and loan institution whenever it determines:

> (A) that . . . (ii) an insured institution has been closed by or under the laws of any State; and
>
> (B) that one or more of the grounds specified in paragraph (6)(A) of section 1464(d) of this title,

existed with respect to such institution at the time a conservator, receiver, or other legal custodian was appointed, or at the time such institution was closed . . .; and

(C) that one or more of the holders of withdrawable accounts in such institution is unable to obtain a withdrawal of his account, in whole or in part; . . . .

12 U.S.C. § 1729(c)(2). Judge Grady concluded in response to defendants' motion for summary judgment that subsections (A) and (C) had been satisfied.

"Thereafter a bench trial was held on the issue of whether subsection (B) had been satisfied. The FHLBB argued that applying the statutory test of insolvency, which is whether the 'assets of the association are less than its obligations to its creditors and others . . .,' 12 U.S.C. § 1464(d)(6)(A)(i), Telegraph had been insolvent at the time of the appointment. Therefore, the FHLBB contended, section 1729(c)(2)(B) had also been fulfilled. Judge Grady agreed and entered judgment in favor of defendants."

The Court of Appeals also stated (slip opinion, pp. 6-8):

"The difference between a situation where the state appoints the FSLIC receiver and one where the FHLBB appoints the FSLIC receiver is the type of judicial review available. A section 1729(c)(1) receivership, where the receiver is appointed by the state commissioner acting pursuant to state law, can be challenged in state court. In contrast, where the FHLBB, acting on its own, appoints the FSLIC receiver the challenge to that receivership can be raised only in federal court. 12 U.S.C. § 1464(d)(6)(A).

* * *

"Telegraph characterizes the takeover orchestrated jointly by state and federal officials as a sham procedure because it created a receivership which could be challenged only in federal court. It emphasizes that if the Commissioner had assumed custody and appointed the FSLIC receiver without acting in con-

junction with federal authorities, the Commissioner's finding of an emergency situation justifying the take-over without prior written notice could have been challenged in state court. Since the FHLBB, rather than the state, appointed the FSLIC receiver, however, Telegraph was restricted to challenging the action in federal court. And since the district court held that the issue of whether Telegraph was closed in compliance with state law was irrelevant to the issue of whether the FHLBB properly determined that Telegraph was insolvent under 12 U.S.C. § 1464(d), Telegraph claims that it was caught in a 'jurisdictional gap between the state and federal spheres, leaving [Telegraph] without a forum.' Appellant's br. at 31. As a result of this 'jurisdictional gap,' Telegraph complains there is no court where the issue of whether the Commissioner acted in compliance with state law can be raised."

With reference to Telegraph's right to judicial review, the Court of Appeals said (slip opinion, pp. 9-10):

"The fact that the receivership must be challenged in federal court instead of state court, however, does not deprive Telegraph of effective judicial review. While the statute, as amended, makes no provision for reviewing actions of the state authorities, it does provide for a full review of whether the FHLBB was justified in appointing the FSLIC. In the overall statutory scheme the loss of review in state court is a trade-off for federal insurance. Congress has concluded that the interests of FSLIC's financial integrity demand that the FHLBB be able to assert its authority when it deems necessary. It has also provided for full review in federal court of whether Telegraph's financial condition justified appointment of a receiver. Thus, it is difficult to understand how Telegraph can complain that it has been denied a forum.

* * *

"When, as here, the state and federal authorities cooperate to close a state institution and appoint the

FSLIC receiver in an effort to minimize financial risks and prevent depositor panic, compliance with the closing precondition becomes 'substantially a ceremonial formality.' *Fidelity Savings & Loan Ass'n v. Federal Home Loan Bank Board*, 689 F.2d 803, 813 (9th Cir. 1982). Thus, what Telegraph characterizes as a sham proceeding was merely the cooperative effort of state and federal authorities to protect depositors while at the same time minimizing FSLIC liability.

"Yet, Telegraph has failed to show that denial of state court review deprived it of any rights. The evidence overwhelmingly establishes that Telegraph was in precarious financial condition and was continuing to decline. The evidence also establishes that Telegraph attended numerous meetings in 1979 and 1980 where Telegraph was put on notice that both state and federal officials intended to act unless its financial condition stabilized.

"Telegraph apparently believes its financial situation was not sufficiently precarious to justify the appointment of a receiver and that it should have a full opportunity to challenge the appointment. We agree. And that is precisely the opportunity it had in federal court. The mere fact that its challenge to the receiver's appointment had to be framed with reference to section 1729(c)(2)'s requirements rather than by way of a challenge to the Commissioner's exercise of his state authority is not significant. Both challenges required Telegraph to establish that it was not insolvent or operating in a manner which put its depositors' money at risk. It had this opportunity in federal court and failed. Full judicial review has been granted."

The Court of Appeals, concerning Telegraph's contention that it had been deprived of a forum in which to litigate its challenge to the Commissioner's takeover without prior written notice and a finding of an emergency, stated (slip opinion, pp. 19-20):

"Telegraph claims that Judge Marshall erred in refusing to sever and remand the state law counts against the commissioner. It also asserts that Judge Marshall's determination that the state claims were 'part and parcel' of the federal action was contradicted by Judge Grady's later ruling that a challenge to the Commissioner's action should be litigated in state court. Telegraph maintains that these two rulings operated to deny it the right to challenge the Commissioner's ex parte state action, a right which is granted by Ill. Rev. Stat. ch. 32, § 852. Telegraph complains that as a result of the two contradictory rulings it has no forum in which to challenge the Commissioner's finding that there was an emergency situation justifying a takeover without prior written notice.

"We find nothing contradictory in the two rulings. Judge Marshall refused to remand the claim against the Commissioner because he believed that all Telegraph's claims were part of its challenge to the FHLBB's appointment of the FSLIC as receiver and that a challenge to a federal receivership could be maintained only in federal court. Judge Grady held that review of state law questions was not part of an action to challenge a receiver under 12 U.S.C. § 1729(c)(2). The fact that Judge Grady dismissed the separately pleaded state law counts without prejudice merely indicates that these claims are independent of Telegraph's challenge to a federal receivership under federal law. *The dismissal cannot be read as a ruling on the validity of the state claims.* (Emphasis supplied.)

"Telegraph's real complaint is that the state court judge dismissed Telegraph's second state court action because he read Judge Marshall's dismissal to mean that the state court had no jurisdiction to hear the state claims. *Whether Telegraph has a state cause of action is properly left to the state court. Neither Judge Marshall's ruling nor Judge Grady's ruling is binding on the state court.* Since the state court

dismissal is currently on appeal we leave it for the state appellate court to determine if Telegraph has any valid state claim. (Emphasis supplied.)

"We hold that Judge Grady's ruling and Judge Marshall's ruling are not in conflict and *in no way operate to deny Telegraph a forum in which to challenge the propriety of the Commissioner's action under state law.*" (Emphasis supplied.)

It is apparent from the record before us that the State recognized that the Illinois courts were the proper forum for the disposition of plaintiffs' state law claims; it is also clear that the State, while it so told the Federal courts, also told the state court that the Federal courts had jurisdiction of those claims. Judge Grady properly realized that the State's challenge in the state court to state court jurisdiction of Telegraph's state law claims because of the claimed exclusive Federal jurisdiction and its challenge in the Federal court to that court's jurisdiction over state law claims could result in Telegraph being "whip-sawed" by being left without a forum in which to settle its state law claims.

Defendant appears to argue that because the trial court granted his motion to dismiss based in part on the pendency of the Federal court action as "another action pending between the same parties for the same cause" (section 48(1)(c) of the Civil Practice Act, Ill. Rev. Stat. 1979, ch. 110, par. 48(1)(c), now codified as section 2-619(a)(3) of the Code of Civil Procedure, Ill. Rev. Stat. 1981, ch. 110, par. 2-619(a)(3)), the subsequent actions of the Federal courts, either District or Court of Appeals, can have no effect in the case at bar. We disagree.

In *International Games, Inc. v. Sims* (1982), 111 Ill. App. 3d 922, 444 N.E.2d 736, it was stated with reference to a Federal court's failure to pass on state law claims (111 Ill. App. 3d 922, 927):

"IGI is properly concerned, of course, that it may find itself without any redress for its grievances if the Federal court rules that it has no jurisdiction over Sims' State law claims. This apprehension will be

present in almost all section 48(1)(c) motions where the other action is pending in Federal court. Such speculation, however, cannot inhibit a court from exercising its discretion, for section 48(1)(c) can be used whenever another suit for the same cause and between the same parties is pending in another county, another State or in the Federal courts. (*Skolnick v. Martin* (1964), 32 Ill. 2d 55, 59-60, 203 N.E.2d 428.) If the Federal court ultimately dismisses Sims' state law claims for lack of jurisdiction, IGI can reinstitute this complaint. Dismissal under section 48(1)(c) will not bar a subsequent suit in Illinois, because the ruling is not upon the merits of IGI's claim. Presently, IGI may file this action as a compulsory counterclaim to the Federal suit and have its charges heard with that suit."

Written notice was not given to Telegraph. It contends that it is entitled to a determination by a state court as to the existence of an emergency which would give the Commissioner the right to dispense with the giving of notice. We agree. Whatever the binding effect of the opinion of the Court of Appeals may be on certain facets of the litigation, it does not necessarily foreclose a finding by the state court of a lack of an emergency. Under the reasoning of *International Games*, Telegraph has a right to have its state law claims resolved in a state court.

The inconsistent positions taken by the State require a reversal of the dismissal by the circuit court of Cook County and a remandment to that court to determine whether the Commissioner exceeded his state powers under section 7-8 (ch. 17, par. 3191) and to what relief plaintiffs are entitled under section 7-12 (ch. 17, par. 3195).

Although the trial court in dismissing also held that injunctive relief against the Commissioner would be completely ineffective because he no longer had custody of Telegraph, that fact does not in and of itself bar plaintiffs from relief. Section 7-12 provides "[i]f upon a hearing thereon, the court finds that such grounds [legal grounds for taking custody] did not or do not then exist,

it may enter an appropriate order in accordance with the findings of fact, * * *." This provision may give a right to damages. The Court of Appeals in a footnote (slip opinion, p. 8) so noted:

> "Although it held that the federal appointment could not be challenged under state law, the district court noted that if either the state or federal authorities violated state law, Telegraph may have an action for damages under Illinois law, Ill. Rev. Stat. ch. 32, § 852, or under federal law, 42 U.S.C. § 1983."

[Ch. 32, par. 852, is now section 7-12 of the Illinois Savings and Loan Act.] See *Mensik v. Smith* (1960), 18 Ill. 2d 572, 586, 166 N.E.2d 265.

Defendant contends that such relief is not available to plaintiffs because they neither asked specifically for damages nor tendered an amendment so asking. Plaintiffs' prayer for relief, however, prayed for "such other relief as is equitable." The prayer for general relief "is the best prayer next to the Lord's prayer. (See *VanZanten v. VanZanten* (1915), 269 Ill. 491, 497, 109 N.E. 986.) In addition, plaintiffs twice requested, once orally and once in a reply to the Commissioner's brief in support of the motion to dismiss, an opportunity to amend.

On remand, plaintiffs, if they so see fit, will have the opportunity to move to amend to specifically seek damages and to transfer the cause to the Law Division. At that time their right to damages under section 7-12 can be fully presented to and considered by the trial court.

Because we hold that, under the circumstances shown, plaintiffs are entitled to have a state court pass on the state law questions, we find it unnecessary to consider other questions raised by defendant in this court to sustain the dismissal. They can be raised in and be passed upon by the circuit court.

The order of the circuit court of Cook County is reversed and the cause remanded for further proceedings.

REVERSED and REMANDED.

McNAMARA, P. J., and McGILLICUDDY, J., concur.

APPENDIX D

[Entered June 30, 1980]

IN THE
CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT
CHANCERY DIVISION

No. 80 CH 4170

TELEGRAPH SAVINGS
& LOAN ASS'N

v.

SCHILLING

ORDER

This cause coming on to be heard on the motion of defendant to dismiss, due notice having been given, the court having considered the memoranda submitted by counsel and having heard oral argument and being fully advised in the premises,

IT IS HEREBY ORDERED, for the reasons stated of record that this matter be, and is hereby dismissed, with prejudice.

Enter:

/s/ George A. Higgins
Judge

APPENDIX E

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Nos. 80-2012, 82-1635 & 82-1702

TELEGRAPH SAVINGS AND LOAN ASSOCIATION, *et al.*,
Plaintiffs-Appellants,

v.

WILLIAM J. SCHILLING, *et al.*,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 80 C 2792—**John F. Grady**, *Judge.*

No. 82-1457

TELEGRAPH SAVINGS AND LOAN ASSOCIATION, *et al.*,
Plaintiffs-Appellants,

v.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION, FEDERAL HOME LOAN BANK BOARD and WILLIAM J. SCHILLING,
Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 80 C 2782—**Prentice H. Marshall**, *Judge.*

ARGUED DECEMBER 9, 1982—DECIDED MARCH 29, 1983

Before BAUER, COFFEY, *Circuit Judges*, and HOFFMAN, *Senior District Judge.**

* The Hon. Walter E. Hoffman, Senior Judge of the United States District Court for the Eastern District of Virginia, is sitting by designation.

BAUER, *Circuit Judge.* In this appeal Telegraph Savings & Loan Association (Telegraph) challenges its closure by the Illinois Commissioner of Savings and Loan Associations (Commissioner), the appointment of the Federal Savings & Loan Insurance Corporation (FSLIC) as receiver and the subsequent sale of Telegraph's assets to First Federal Savings & Loan Association. The district court held that the takeover and sale were proper. We affirm.

Telegraph was an Illinois chartered savings and loan association owned by one hundred and twenty stockholders and insured by the FSLIC. In the late 1970's Telegraph began experiencing financial difficulties. As a result of heavy losses, it was unable to satisfy the reserve and net worth minimums required by 12 C.F.R. § 563.13. When Telegraph's financial condition continued to decline at an ever-increasing rate, the state and federal officials charged with regulating savings and loan associations became alarmed. A special meeting was held in October, 1979 to identify the cause of Telegraph's decline and to propose some solutions. Telegraph's Board of Directors and representatives of the Commissioner, the FSLIC and the Federal Home Loan Bank Board (FHLBB) attended. At this meeting the Commissioner concluded that undercapitalization was causing Telegraph's shaky financial condition and indicated that, unless this situation was remedied, the state would have to assume custody.

Additional meetings were held in 1979 and 1980 to monitor Telegraph's financial status and to develop a plan for infusing Telegraph with new capital. Possible mergers were considered but only one concrete plan surfaced. The Heron Corporation offered to purchase 80% of Telegraph's preferred stock if the FSLIC would finance the purchase with a fifteen year interest free loan.[1] The FHLBB vetoed the Heron Proposal.

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[1] Although the Heron Corporation offered only seven million dollars for the stock, its offer was contingent on obtaining a fif-

(Footnote continued on following page)

When no other buyers came forward, the Commissioner and federal officials concluded that they had no choice but to take control. A takeover plan was devised whereby the Commissioner would assume custody of Telegraph and FHLBB would immediately appoint the FSLIC receiver. The FSLIC, in turn, would immediately transfer Telegraph's assets to First Federal Savings & Loan Association under a purchase and assumption agreement.

According to this prearranged plan, the takeover was effected on May 22, 1981 at Telegraph's main office. Just before the usual closing time the Commissioner served Telegraph's president with a notice that the state was assuming immediate custody. The notice explained that Telegraph's financial instability had created an emergency situation which necessitated the takeover. Telegraph had not received prior written notice of this decision.[2] After serving the president with the notice, the Commissioner sent his deputy to the teller's window where one of Telegraph's customers, A. Raymond Bacon, was waiting to withdraw twenty-five dollars. Bacon was making the withdrawal solely because the FHLBB had requested him to do so. When Bacon approached the teller, the deputy intervened. He took the withdrawal slip from Bacon and handed it, along with an affidavit stating that Bacon had been unable to withdraw his money, to the FHLBB agent. The purchase and assumption agreement was executed immediately and the next day Telegraph's operation opened under First Federal's name.

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[1] *continued*
teen million dollar, fifteen year interest free loan from the FSLIC, with an option to extend the loan for five more years at six per cent interest.

[2] ILL. REV. STAT. ch. 32 § 848, which authorizes the Commissioner to assume custody, provides that "[u]nless the Commissioner finds that an emergency exists which may result in loss to members or creditors and requires that he take custody immediately, he first shall give written notice to the directors, trustees, or liquidators specifying the conditions criticized and state a reasonable time within which correction may be made."

Telegraph then filed identical actions challenging the takeover and the appointment of the FSLIC as receiver in the federal court for the Northern District of Illinois and in the state court in the Circuit Court of Cook County. The federal action was assigned to Judge Grady. The state action was removed to federal court and assigned to Judge Marshall. Judge Marshall held that federal courts have exclusive jurisdiction over any action to remove the FSLIC as receiver and concluded that, since the state court never had jurisdiction over the action, it had no authority to remove it to federal court. Declining to grant Telegraph's request to remand back to the state court, Judge Marshall dismissed the action. Telegraph appealed to this court.

Telegraph also filed a new state court action, this time proceeding against the Commissioner but not the federal agencies. The state court, relying on Judge Marshall's opinion that federal courts have exclusive jurisdiction, dismissed that action. Telegraph appealed this dismissal; that appeal is currently pending in the state court.

The central issue in the case proceeding before Judge Grady was whether the requirements for appointment of an FSLIC receivership, set forth in 12 U.S.C. § 1729(c)(2) had been satisfied. Section 1729(c)(2) provides that the FHLBB has the authority to appoint the FSLIC receiver over a state savings and loan institution whenever it determines:

> (A) that . . . (ii) an insured institution has been closed by or under the laws of any State; and
>
> (B) that one or more of the grounds specified in paragraph (6)(A) of section 1464(d) of this title, existed with respect to such institution at the time a conservator, receiver, or other legal custodian was appointed, or at the time such institution was closed . . . ; and
>
> (C) that one or more of the holders of withdrawable accounts in such institution is unable to obtain a withdrawal of his account, in whole or in part; . . . .

12 U.S.C. § 1729(c)(2). Judge Grady concluded in response to defendants' motion for summary judgment that subsections (A) and (C) had been satisfied.

Thereafter a bench trial was held on the issue of whether subsection (B) had been satisfied. The FHLBB argued that applying the statutory test of insolvency, which is whether the "assets of the association are less than its obligations to its creditors and others . . . ," 12 U.S.C. § 1464(d)(6)(A)(i), Telegraph had been insolvent at the time of the appointment. Therefore, the FHLBB contended, section 1729(c)(2)(B) had also been fulfilled. Judge Grady agreed and entered judgment in favor of defendants.

On appeal Telegraph assigns numerous errors. It argues that the district court erred in granting partial summary judgment because the trial judge erroneously refused to consider state law issues which raised questions of material fact precluding summary disposition. It also asserts that subsections (A) and (C) cannot be satisfied by a prearranged closing orchestrated in tandem by state and federal authorities because such joint action subverts the purpose of the statute. With respect to the trial, Telegraph asserts that the finding that Telegraph was insolvent must be reversed because: (1) the statutory test of insolvency is unreliable and irrational; (2) highly relevant evidence was improperly excluded; and (3) the judge did not accord proper weight to the testimony of Telegraph's primary witness. Judge Marshall's dismissal of the action removed from state court is also part of this appeal, as are numerous rulings relating to Counts I, II, IV, VI, IX and X.

Before analyzing Telegraph's contentions, we note that Telegraph attempts to support its position with a myriad of arguments, some of which are unsupported by legal authority. Since many of these arguments were raised, fully analyzed, and properly rejected by the trial judge in four extensive memorandum opinions, *Telegraph Savings & Loan Ass'n v. Federal Savings & Loan Insurance Corp.*, No. 80 C 2792, slip ops. (N.D. Ill. Mar. 18, 1982;

Feb. 19, 1982; Aug. 4, 1981; June 9, 1981), we confine our analysis to those arguments which are dispositive of this appeal.

I

A basic understanding of the federal statutory scheme is essential to an analysis of the technical issues and specific sections involved here. The National Housing Act, 12 U.S.C. § 1701 *et seq.* created the FSLIC, under the direction of the FHLBB, to insure both federal and state savings and loan associations. 12 U.S.C. § 1725(a). When the statute was first enacted, the FSLIC could become receiver for a state savings and loan association only if the state requested its appointment. The FHLBB did not have independent authority to appoint the FSLIC as receiver for a state institution. 12 U.S.C. § 1729(c)(1).

Under section 1729(c)(1), the FSLIC was obligated to make insurance payments when a state association failed, even in situations where the state had refused to appoint the FSLIC as receiver, and, thus had deprived it of any voice in the liquidation process. For this reason, in 1968, after several state associations had failed and state authorities had refused to appoint the FSLIC receiver, the statute was amended to provide for greater federal control. Senate Report No. 1263, 90th Cong., 2d Sess. *reprinted in* 1968 U.S. CODE CONG. & AD. NEWS 2530, 2534. Section 1729(c)(2) was added, granting the FHLBB independent authority to appoint the FSLIC receiver for a state institution regardless of whether the state requested the appointment, whenever certain statutory requirements, enumerated in 12 U.S.C. § 1464(d), were satisfied.

The difference between a situation where the state appoints the FSLIC receiver and one where the FHLBB appoints the FSLIC receiver is the type of judicial review available. A section 1729(c)(1) receivership, where the receiver is appointed by the state commissioner acting pursuant to state law, can be challenged in state court. In contrast, where the FHLBB, acting on its own, appoints

the FSLIC receiver the challenge to that receivership can be raised only in federal court. 12 U.S.C. § 1464(d)(6)(A).

A. The Closing "By or Under" State Law

Telegraph characterizes the takeover orchestrated jointly by state and federal officials as a sham procedure because it created a receivership which could be challenged only in federal court. It emphasizes that if the Commissioner had assumed custody and appointed the FSLIC receiver without acting in conjunction with federal authorities, the Commissioner's finding of an emergency situation justifying the takeover without prior written notice could have been challenged in state court.[3] Since the FHLBB, rather than the state, appointed the FSLIC receiver, however, Telegraph was restricted to challenging the action in federal court. And since the district court held that the issue of whether Telegraph was closed in compliance with state law was irrelevant to the issue of whether the FHLBB properly determined that Telegraph was insolvent under 12 U.S.C. § 1464(d), Telegraph claims that it was caught in a "jurisdictional gap between the state and federal spheres, leaving [Telegraph] without a forum." Appellant's br. at 31. As a result of this "jurisdictional gap," Telegraph complains there is no court where the issue of whether the Com-

[3] The packet of custody and receivership documents used by the Commissioner on May 22 when he assumed custody were prepared by private attorneys representing the FHLBB and the FSLIC. These documents were given to the Commissioner on March 28. A prior written notice of intent to assume custody was not included. Telegraph insists that the fact that the documents were prepared nearly two months before they were used indicates that no emergency existed. Thus, it contends that the Commissioner violated Illinois law by failing to give prior written notice.

missioner acted in compliance with state law can be raised.[4]

The district court, relying on S. Rep. No. 1263, 90th Cong., 2d Sess., *reprinted in* 1968 U.S. CODE CONG. & AD. NEWS 2530, 2534, rejected Telegraph's argument. It reasoned that Congress drafted section 1729(c)(2) purposely to limit challenges to FSLIC's appointment by the FHLBB to the federal courts because it intended the FHLBB's conduct to be evaluated under uniform federal law. Thus, the district court held that the closure requirement of section 1729(c)(2)(A) is met whenever an institution is closed by state officials. Since no party disputed that Telegraph was closed by state officials on May 22, the district court held that the closure requirement had been satisfied.

Citing no authority supporting its position, Telegraph would have us believe that it is always entitled to challenge a FSLIC receivership in state court. Neither the statutory language nor the legislative history supports Telegraph's contention. Section 1729(c)(2)(A)(ii) requires that "an insured institution has been closed by or under the laws of any State." 12 U.S.C. § 1729(c)(2)(A)(ii). The closing "by or under" state law triggers the FHLBB's authority. No language in this section requires the FHLBB to evaluate whether or not the closing was in compliance with state law. Our interpretation is supported by S. Rep. No. 1263, which states that Congress amended section 1729(c) in order to safeguard the financial integrity of the FSLIC and "to enable the FSLIC to defend its appointment under federal law instead of requiring it to defend the legality of the State savings and loan administrator's determinations under State law." S.

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[4] Although it held that the federal appointment could not be challenged under state law, the district court noted that if either the state or federal authorities violated state law, Telegraph may have an action for damages under Illinois law, ILL. REV. STAT. ch. 32, § 852, or under federal law, 42 U.S.C. § 1983.

Rep. No. 1263, 90th Cong., 2d Sess., *reprinted in* 1968 U.S. CODE CONG. & AD. NEWS 2530, 2540.

The fact that the receivership must be challenged in federal court instead of state court, however, does not deprive Telegraph of effective judicial review. While the statute, as amended, makes no provision for reviewing actions of the state authorities, it does provide for a full review of whether the FHLBB was justified in appointing the FSLIC. In the overall statutory scheme the loss of review in state court is a trade-off for federal insurance. Congress has concluded that the interests of FSLIC's financial integrity demand that the FHLBB be able to assert its authority when it deems necessary. It has also provided for full review in federal court of whether Telegraph's financial condition justified appointment of a receiver. Thus, it is difficult to understand how Telegraph can complain that it has been denied a forum.

We note that the Ninth Circuit, presented with a similar factual situation, also has concluded that whenever the state closes an institution and the FSLIC is appointed as state receiver, section 1729(c)(2)(A)'s closing requirement is satisfied. *Fidelity Savings & Loan Ass'n v. Federal Home Loan Bank Board*, 689 F.2d 803, 813 (9th Cir. 1982). Telegraph attempts to distinguish *Fidelity* by claiming that the right it seeks to assert here, the right to review the actions of state officials according to state law, was granted in *Fidelity*. Telegraph misreads the case. In *Fidelity* the state law did not explicitly grant the Commissioner the power to close a state institution. Construing the Commissioner's statutory powers broadly, however, the *Fidelity* court held that the power to close an association under California law was properly implied from the Commissioner's power to take possession of an association for the purpose of liquidation. Having reached this conclusion, the *Fidelity* court did not, as Telegraph would have us do, sit in judgment on whether the Commissioner should have initiated the closure nor did it analyze whether the procedures by which the closure was effected complied with state law.

Where, as here, the state and federal authorities cooperate to close a state institution and appoint the FSLIC receiver in an effort to minimize financial risks and prevent depositor panic, compliance with the closing precondition becomes "substantially a ceremonial formality." *Fidelity Savings & Loan Ass'n v. Federal Home Loan Bank Board*, 689 F.2d 803, 813 (9th Cir. 1982). Thus, what Telegraph characterizes as a sham proceeding was merely the cooperative effort of state and federal authorities to protect depositors while at the same time minimizing FSLIC liability.

Yet, Telegraph has failed to show that denial of state court review deprived it of any rights. The evidence overwhelmingly establishes that Telegraph was in precarious financial condition and was continuing to decline. The evidence also establishes that Telegraph attended numerous meetings in 1979 and 1980 where Telegraph was put on notice that both state and federal officials intended to act unless its financial condition stabilized.

Telegraph apparently believes its financial situation was not sufficiently precarious to justify the appointment of a receiver and that it should have a full opportunity to challenge the appointment. We agree. And that is precisely the opportunity it had in federal court. The mere fact that its challenge to the receiver's appointment had to be framed with reference to section 1729(c)(2)'s requirements rather than by way of a challenge to the Commissioner's exercise of his state authority is not significant. Both challenges required Telegraph to establish that it was not insolvent or operating in a manner which put its depositors' money at risk. It had this opportunity in federal court and failed. Full judicial review has been granted.

B. The Withdrawal Requirement

Section 1729(c)(2)(C) requires that "one or more of the holders of withdrawable accounts . . . is unable to obtain a withdrawal of his account . . . ." 12 U.S.C.

§ 1729(c)(2)(C). The district court held that this requirement had no meaning independent from subsection (A), requiring that the association be closed by or under state law, because "once an association is closed, no depositor can get his money."[5] *Telegraph Savings & Loan Ass'n v. Federal Savings & Loan Insurance Corp.*, No. 80 C 2792, slip op. at 17 (N.D. Ill. June 9, 1981).

Emphasizing that a statute must not be construed so as to render certain provisions superfluous, Telegraph challenges the district court's conclusion that subsection (C) is automatically satisfied whenever an association is closed. It asserts that Congress amended section 1729(c) to include the withdrawal requirement in order to limit FHLBB's authority to appoint the FSLIC receiver. Telegraph maintains that FHLBB's authority is triggered only in those situations where the association is in such financial distress that it lacks funds to honor withdrawal requests and an insurance payout is necessary to preserve public confidence and to prevent undue hardship on the account holders. It argues that the ruling that subsection (C) is "mere surplusage is impossible to square with the fact that this provision was added by Congress by amendment to a bill that already contained the first requirement that the association be closed by and under state law." Appellant's br. at 23.

Appellees respond that the interpretation that requirement (C) is automatically satisfied whenever an association is closed does not mean that this subsection is superfluous. They note that requirement (C) was added at the same time that requirement (A) was amended and maintain that both amendments must be construed together. Subsection (A) was amended to permit the FHLBB to appoint the FSLIC receiver whenever a receiver had been appointed by an authority other than the FHLBB and that appointment has been in effect for at least fifteen consecutive days. Under appellees' interpretation, subsection (C) has independent significance in a

[5] The *Fidelity* court reached the same conclusion.

situation where a state commissioner takes custody of an association for the purpose of operating it. In this situation the statute permits the FHLBB to make a receivership appointment after fifteen days even though the state commissioner is still attempting to operate the association, only in the event that a depositor is unable to obtain a withdrawal. Thus, appellees believe subsection (C)'s purpose is to confine the FHLBB's intervention to situations where depositors are unable to withdraw their money despite the state commissioner's efforts to keep the institution open.

The legislative history supports appellees' construction. In discussing the amendments to subsections (A) and (C) the committee stated:

> the committee amendment requires the Board to find that the shareholders are unable to obtain a withdrawal of their savings in whole or in part. The Board must also wait for at least 15 days from the time the State has appointed a receiver before the FSLIC can be appointed as receiver. This is intended to confine the use of the Board's authority to the most urgent situations and to preclude FSLIC receivership in those cases where State authorities have appointed a receiver or conservator for only a brief period.

S. Rep. No. 1263, 90th Cong., 2d Sess., reprinted in 1968 U.S. CODE CONG. & AD. NEWS 2530, 2541. These comments indicate that subsection (C)'s withdrawal requirement and subsection (A)'s fifteen day requirement go hand in hand. Subsection (C) clearly is not superfluous.

The fact that subsection (C) is not "mere surplusage" does not mean, however, that the withdrawal requirement must have independent significance in a situation where state and federal authorities are cooperating in the closing and appointment of receiver. The withdrawal requirement, like the closure precondition, is, under the circumstances here, "substantially a ceremonial formality." *Fidelity Savings & Loan Ass'n v. Federal Home Loan Bank Board*, 689 F.2d 803, 813 (9th Cir. 1982).

Accordingly, we agree with the district court that subsections 1729(c)(2)(A) and 1729(c)(2)(C) have been satisfied.

II

We next consider the trial errors Telegraph assigns. The issue at trial was whether one of the grounds enumerated in 12 U.S.C. § 1464(d)(6)(A) existed at the time the FSLIC was appointed. Section 1464(d)(6)(A) specifies five grounds for the appointment of a receiver. The FHLBB relied on two of these grounds: (i) insolvency and (ii) an unsafe or unsound condition to transact business. Since the more complicated issue of whether Telegraph was unsafe and unsound would never have to be considered if Telegraph was found to be insolvent, the trial judge limited the trial to the insolvency issue.

The gravamen of Telegraph's complaint is that the trial court erred in applying the statutory test of insolvency because the test, *"whether it is required by the language of the Statute or not, is economically and financially irrational in application."* Appellant's br. at 34 (emphasis in the original). Telegraph also contends that the statute unconstitutionally violates its property and contract rights.

Additionally, Telegraph challenges numerous trial rulings. It asserts that the trial judge unduly restricted the scope of trial by excluding the issue of whether the FHLBB reasonably rejected the Heron Proposal and by preventing discovery on FHLBB's policies and practices with respect to other state institutions. These exclusions, Telegraph contends, deprived it of the only effective means of proving that the FHLBB's application of the statutory insolvency test was arbitrary or irrational. It also contends that the trial judge did not accord Secretary Mehle's testimony the great weight to which it was entitled, or apply the correct standard of review to the constitutional challenge. Finally, it claims that the attorneys for the federal agencies should have been disqualified.

A. The Book Net Worth Standard of Insolvency.

The FHLBB employed the book net worth test to determine that Telegraph was insolvent. Under this test liabilities are subtracted from assets valued at book value. The trial judge held that FHLBB's method of calculations was permissible under 12 U.S.C. § 1464(d)(6)(A), which provides that insolvency is computed by subtracting "obligations to its creditors and others" from "assets of association." Section 1464(d)(6)(A) does not specify what constitutes "obligations" or how to value "assets."

Telegraph contends that the book net worth test does not comply with section 1464(d)(6)(A) because it does not accurately evaluate an institution's financial stability. It argues that in order to conform to the statute's purpose of predicting the degree of risk to FSLIC funds, assets must be valued at fair market value and obligations should include only those liabilities currently due. Under Telegraph's definitions obligations do not include deferred taxes or deferred loan fees. Had the FHLBB defined assets and obligations as urged by Telegraph, it could not have found Telegraph insolvent on the day of the takeover.[6]

At trial Telegraph introduced statistics to support its contention that an institution's book net worth bears no relationship to its true net worth. It buttressed these statistics with the testimony of the Assistant Secretary of the Treasury for Domestic Finance, Roger W. Mehle. Mehle testified that it was his personal belief that the book net worth test of insolvency was meaningless. Based on this evidence, Telegraph insisted that the FHLBB's method of computing insolvency was "unique," "irrational" and "prejudicial."

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[6] Telegraph had more than eleven million dollars in liquid assets at the time Bacon attempted to withdraw twenty-five dollars.

The trial judge held that the book net worth method of evaluating an institution was valid under section 1464(d)-(6)(A) and, hence, that the FHLBB's determination that Telegraph was insolvent on the day of its closure was reasonable. He noted that an agency's interpretation of a statute is entitled to a presumption of validity and emphasized that although Congress revised section 1464(d) in 1966 and again in 1978, it has never altered the subsection granting the FHLBB authority to appoint a receiver after a determination that an institution is insolvent. The court also noted that since 1954 the FHLBB has been computing insolvency based on financial data contained in Monthly Reports which savings and loan associations prepare and file and that these reports reflect the total book value of an association's assets and its total liabilities.

The trial judge rejected Telegraph's definitions of the terms "obligations" and "assets." In so doing, he relied heavily on the testimony of Kenneth Scott, former general counsel of FHLBB. Telegraph believes that the trial judge should have placed more reliance on the testimony of Assistant Secretary Mehle. We may not, however, set aside a trial court's findings, particularly where those findings are based primarily upon the credibility of witnesses, unless those findings are clearly erroneous. *Lee v. National Can Corp.*, No. 81-2944, slip op. (7th Cir. Feb. 8, 1983). While reasonable people may differ as to which witnesses were more credible, we cannot say that the trial judge's reliance on witnesses other than Mehle[7] was clearly erroneous.

Based on an analysis of testimony from witnesses on both sides, the legislative history and "generally accepted

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[7] We also have considered Telegraph's argument that Mehle's testimony reflects official Treasury policies and, thus, should be construed as admissions against the federal agencies. This argument is without merit. Since Mehle testified in an individual, rather than official, capacity his remarks cannot be imputed to the federal agencies.

accounting principles and regulatory accounting principles," *Telegraph Savings & Loan Ass'n v. Federal Savings & Loan Insurance Corp.*, No. 80 C 2792, slip op. at 7 (N.D. Ill. Feb. 19, 1982), the trial judge held that "obligations" includes all liabilities. He emphasized that since 1954 the FHLBB has valued an association's assets at book value and that Congress had never attempted to pass a statute requiring the FHLBB to value an association's assets in a different manner. For this reason, the trial judge concluded that valuation at book value was proper. Accordingly, he held that the FHLBB's construction of section 1464(d)(6)(A) was consistent with congressional intent and the statutory language.

We believe the trial court's analysis is correct. Telegraph's assertion that the statute is "unique" or "irrational" is a legislative matter for Congress to address and is irrelevant to the resolution of this controversy. The statute requires the FHLBB to determine if an association is insolvent by subtracting its obligations from its assets. The FHLBB's definitions of "assets" and "obligations" comply with the statutory mandate. Accordingly, regardless of whether Telegraph agrees with the statutory test, it is the law and we are bound by it.

We also reject Telegraph's contention that even if the FHLBB's construction of the statute accurately reflected whether an association was insolvent in 1954 the book net worth test has since become invalid because of changes in the circumstances to which it applies. Telegraph emphasizes that in 1954, when section 1464(d)(6)(A) was drafted, most of an association's accounts were regular passbook accounts. Since these accounts were not subject to any penalty, all interest accrued was actually paid out. Thus, the book value and market value of an association's assets were approximately the same. Today, because the commonly held accounts are certificate or term accounts rather than regular passbook accounts, the book value is considerably higher than market value. While for accounting purposes the interest on these term accounts is recorded as liabilities, many of these term accounts are

redeemed before their maturity dates and because of the penalty attached to early redemption, the association pays less interest than the recorded liabilities. Therefore, assuming *arguendo*, that valuing assets at book minus total liabilities accurately reflected an association's financial stability when most of the association's accounts were regular savings accounts, Telegraph insists it does not do so when the nature of the accounts has changed.

We cannot agree. The fact that Congress has never attempted to change the method the FHLBB uses to compute insolvency is strong evidence that Congress intended insolvency to be determined by the book net worth test. Telegraph would have us redraft the statute to conform to its idea of economic policy. Our task, however, is to enforce the law as Congress saw fit to enact it.

We believe the trial judge properly concluded that the FHLBB may, consistent with the statute, compute insolvency in terms of negative net worth, based on a valuation of assets at book value. Accordingly, the FHLBB's calculations, arrived at by subtracting all liabilities from the book value of all the assets, were reasonable.[8]

B. The Constitutional Challenge

Telegraph also challenges section 1464(d)(6)(A) on substantive due process grounds. It asserts that FHLBB's authority extends only to situations involving possible risk to FSLIC insurance funds and reasons that the receivership criteria set forth in section 1464(d)(6)(A)(i), and incorporated by section 1729(c)(2)(B), do not accurately reflect

[8] Telegraph also challenges other trial court rulings. It maintains that: (1) the issue of whether the FHLBB properly rejected the Heron Proposal should not have been excluded from trial; (2) the receivership should not be evaluated according to notions of "trends in operating losses" and "public confidence"; and; (3) counsel for the federal agencies should have been disqualified. We have carefully examined these arguments and find them to be without merit.

whether an institution is insolvent. Telegraph maintains that since the criteria do not indicate when FSLIC funds are at risk, appointment of the FSLIC as receiver according to these criteria violates its substantive due process right.

In analyzing the statute's constitutionality the district court stated that the statute was not violative of substantive due process if it was rationally based and free from invidious discrimination. It concluded that the statute was not unconstitutional because application of the book net worth test is a rational means of protecting FSLIC insurance funds.

Telegraph contends the trial court should have applied a higher standard of review. Yet, although Telegraph claims the trial judge improperly relied on *New Orleans v. Dukes*, 427 U.S. 297 (1976), and *Breard v. City of Alexandria*, 341 U.S. 622 (1951), to support the application of a minimal standard of review to the constitutional challenge, it cites no authority for its contention that the rights involved in this case are property and contract rights requiring strict scrutiny. Nor does it offer any argument to refute the trial judge's conclusion that "[t]he right to do business has never been considered a fundamental right." *Telegraph Savings & Loan Ass'n v. Federal Savings & Loan Insurance Corp.*, No. 80 C 2792, slip op. at 17 (N.D. Ill. Feb. 19, 1982). Finally, Telegraph fails to explain why *United States v. Central Eureka Mining Co.*, 357 U.S. 155 (1958), on which the trial judge heavily relied, does not control.

In *Central Eureka Mining Co.* the government ordered all non-essential gold mines closed in order to free the machines for war-related work. Central Eureka's challenge to the governmental action on substantive due process grounds failed. Applying *Central Eureka* to this case, the trial judge noted, "[i]f a substantive due process challenge to government action that effectively took control over the deployment of the assets of a business is evaluated by the rational basis test, we doubt that a

stricter standard of review is warranted in this case." *Telegraph Savings & Loan Ass'n v. Federal Savings & Loan Insurance Corp.*, No. 80 C 2792, slip op. at 18 (N.D. Ill. Feb. 19, 1982).

We agree that *Central Eureka Mining Co.* controls. Accordingly, the statute is properly evaluated by the rational basis test. Since we have already determined that the statutory test for insolvency may reasonably be said to reflect an association's degree of financial stability, which, in turn, reflects the degree of risk posed to FSLIC insurance funds, the statute satisfies the rational basis test.

III

Telegraph claims that Judge Marshall erred in refusing to sever and remand the state law counts against the Commissioner. It also asserts that Judge Marshall's determination that the state claims were "part and parcel" of the federal action was contradicted by Judge Grady's later ruling that a challenge to the Commissioner's action should be litigated in state court. Telegraph maintains that these two rulings operated to deny it the right to challenge the Commissioner's ex parte state action, a right which is granted by ILL. REV. STAT. ch. 32, § 852. Telegraph complains that as a result of the two contradictory rulings it has no forum in which to challenge the Commissioner's finding that there was an emergency situation justifying a takeover without prior written notice.

We find nothing contradictory in the two rulings. Judge Marshall refused to remand the claim against the Commissioner because he believed that all Telegraph's claims were part of its challenge to the FHLBB's appointment of the FSLIC as receiver and that a challenge to a federal receivership could be maintained only in federal court. Judge Grady held that review of state law questions was not part of an action to challenge a receiver under 12 U.S.C. § 1729(c)(2). The fact that Judge Grady

dismissed the separately pleaded state law counts without prejudice merely indicates that these claims are independent of Telegraph's challenge to a federal receivership under federal law. The dismissal cannot be read as a ruling on the validity of the state claims.

Telegraph's real complaint is that the state court judge dismissed Telegraph's second state court action because he read Judge Marshall's dismissal to mean that the state court had no jurisdiction to hear the state claims. Whether Telegraph has a state cause of action is properly left to the state court. Neither Judge Marshall's ruling nor Judge Grady's ruling is binding on the state court. Since the state court dismissal is currently on appeal we leave it for the state appellate court to determine if Telegraph has any valid state claim.

We hold that Judge Grady's ruling and Judge Marshall's ruling are not in conflict and in no way operate to deny Telegraph a forum in which to challenge the propriety of the Commissioner's action under state law.[9]

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[9] Telegraph also raises arguments with respect to Counts I, II, IV, VI, IX, and X. Counts I and II, which were dismissed without prejudice by Judge Grady, contained state law claims against the Commissioner. Count IV alleged a *Bivens* action. *Bivens v. Six Unknown Named Agents*, 403 U.S. 388 (1971), and a 42 U.S.C. § 1983 claim. Count VI contained a charge against Schilling for misrepresentation. Count IX stated an unlawful creditor preference claim and Count X pled a shareholder derivative action. With the exception of the § 1983 claim in Count IV, these counts were dismissed. The § 1983 claim in Count IV was retained and stayed, pending resolution of the state claims in state court. We have examined Telegraph's arguments with respect to each of these counts and find them to be without merit. The district court properly dismissed all claims except the § 1983 claim.

IV

For all the reasons detailed above, the decision of the lower court is

AFFIRMED.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX F

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 80 C 2792

TELEGRAPH SAVINGS AND LOAN ASSOCIATION, et al.,
Plaintiffs,

v.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION, et al.,
Defendants.

MEMORANDUM OPINION

This is an action brought by Telegraph Savings & Loan Association ("Telegraph" or the "Association") to remove the Federal Savings & Loan Insurance Corporation ("FSLIC") as receiver of its assets and to obtain equitable and monetary relief for harm suffered as a result of the sale of those assets. The complaint is in ten counts and alleges causes of action under a variety of state and federal statutes and constitutional provisions. On June 9, 1981, this court ordered that Count III (which contained the claim that the FSLIC was unlawfully appointed receiver of its assets) be severed from other counts and set for expedited trial.

Trial of Count III began on September 10, 1981, and ran with interruptions through January 7, 1982. The court heard nearly a dozen witnesses, most of them experts in the fields of finance, savings and loan associ-

ations, and accounting. Having considered the testimony and exhibits offered, the court is of the opinion that the FSLIC was lawfully appointed receiver of Telegraph's assets. For the reasons set forth below, we therefore deny the Association's application to remove that agency as receiver.

I. Background

As we discussed in our summary judgment opinion filed June 9, 1981, pursuant to 12 U.S.C. §1729(c)(2) (1980), the Bank Board has "exclusive power and jurisdiction" to appoint the FSLIC receiver for the assets of an insured state savings and loan association in the event that the Bank Board determines:

> (A) that . . . (ii) an insured institution (other than a Federal savings and loan association) has been closed by or under the laws of any State;
>
> (B) that one or more of the grounds specified in paragraph (6)(A) of section 1464(d) of this title, existed with respect to such institution at the time a conservator, receiver, or other legal custodian was appointed, or at the time such institution was closed . . .; and
>
> (C) that one or more of the holders of withdrawable accounts in such institutions is unable to obtain a withdrawal of his account, in whole or in part;

Section 1464(d)(6)(A), referred to in subsection (B) of the foregoing statute, provides that

> The grounds for the appointment of a conservator or receiver for an association shall be one or more of the following:
>
> > (i) insolvency in that the assets of the association are less than its obligations to its creditors and others, including its members: . . . .

In our opinion of June 9, 1981, we held that subsections (A) and (C) of §1729(c)(2) had been satisfied and therefore granted the Bank Board summary judgment. We held, however, that there was an issue of material fact as to

whether Telegraph was insolvent within the meaning of § 1464(d)(6)(A). That issue of fact was as follows: Telegraph had been placed into receivership by the Bank Board on May 22, 1980, on the ground that it was insolvent. The Bank Board had based its determination of insolvency on monthly financial reports filed by the Association with the Bank Board at the end of every month. On April 30, 1980, Telegraph's monthly statement showed that its net worth had fallen to $450,000.00. On May 19, Telegraph's comptroller projected that between May 1 and May 19 the Association had lost over $590,000.00 and that it would lose nearly $1 million for the entire month. On the basis of the comptroller's projections, the Bank Board determined that the Association was insolvent within the meaning of § 1464(d)(6)(A)(i) on May 22, 1981, and that it was therefore eligible for receivership on that day. In opposition to the motion for summary judgment, Telegraph submitted affidavits indicating that the Board's projections were speculative and arbitrary. Although we thought there were strong indications that the defendants' projections were reasonable, we held nonetheless that plaintiffs were entitled to present evidence at trial on the question.

At trial, defendants took a different, and surprising, tack. Rather than dispute the reasonableness of the Bank Board's projections, plaintiffs chose to dispute, by way of an attack on the Board's interpretation of § 1464(d)(6)(A)(i), the *method* by which the Board computed insolvency. When, for reasons set forth below, these challenges to the Bank Board's interpretation of the statute ran into difficulty, plaintiffs mounted a constitutional attack on the statute. Plaintiffs now rely chiefly on this constitutional challenge.

We first address the challenges to the Bank Board's interpretation of the insolvency statute and then the constitutional issues.

II. Challenges To The Bank Board's Construction of § 1464(d)(6)(A)(i)

Section 1464(d)(6)(A)(i) provides that

> The grounds for the appointment of a conservator or receiver for an association shall be one or more of the following: (i) insolvency in that the assets of the association are less than its obligations to its creditors and others, including its members; . . . .

12 U.S.C. § 1464(d)(6)(A) (1980).

The Bank Board has consistently interpreted this statute as defining insolvency in terms of negative net worth based on a valuation of assets at book value. Thus, in determining whether an association is insolvent, the Bank Board merely subtracts all liabilities from the book value of all the assets. If the result is less than zero, the association is considered insolvent within the meaning of the statute.

Plaintiffs asserted that the statute contains certain ambiguities. Specifically, they argued that the terms "assets" and "obligations" are susceptible to interpretations other than the Board has given them and that these other constructions are more consistent with the intent of the statute.

The Bank Board's authority to interpret § 1464(d)(6)(A) is derived from § 1464(a)(1) of the same title. That section states that

> In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as "Federal Savings and Loan Associations . . . .

Section 1464(d)(1) also gives the Bank Board the "power to enforce this section and the rules and regulations made hereunder."[1]

We decide questions of statutory construction in this case with due respect for the "venerable principle that the construction of a statute by those charged with its execution should be followed unless there are compelling indications that it is wrong, especially when Congress has refused to alter the administrative construction. *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1969); *Espinoza v. Farah Manufacturing Co.*, 414 U.S. 86, 94-95 (1973). The degree of deference is enhanced where the agency participated in the development of the statute it administers, *Miller v. Youakim*, 440 U.S. 125, 144 (1979), where the agency has applied the challenged construction consistently over a number of years, *United States v. National Association of Security Dealers*, 422 U.S. 694, 719 (1975); *N.L.R.B. v. Boeing Co.*, 412 U.S. 67, 75 (1973), and where "Congress has re-enacted the statute without pertinent change. In these circumstances, congressional failure to revise or repeal the agency's interpretation is persuasive evidence that the interpretation is the one intended by Congress." *N.L.R.B. v. Bell Aerospace Co.*, 416 U.S. 267, 275 (1974). Finally, we note that "[w]e need not find that the construction is the only reasonable one, or even that it is the one we would have reached had the question arisen in the first instance in judicial proceedings." *Unemployment Compensation Commission of Alaska v. Aragon*, 329 U.S. 143, 153 (1946). *See also Train v. Natural Resources Defense Council, Inc.*, 421 U.S. 60, 75 (1975).

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[1] Section 1464(d)(6)(A) also provides that "[i]f, in the opinion of the Board, a ground for the appointment of a conservator or receiver as herein provided exists," the Board is authorized to make such an appointment. The language "in the opinion of the Board" is further evidence of Congress' intent to delegate interpretation of the statute to the Board.

Before evaluating plaintiffs' statutory construction arguments, we briefly describe the legislative history of § 1464(d)(6)(A)(i). This section was added to Title 12 in 1954 with the advice of the Bank Board itself.[2] Despite the fact that Congress generally revised § 1464(d)(6) in 1966 and made smaller revisions of § 1464(d) in 1978,[3] it has never revised the subsection giving the Bank Board the power to appoint a receiver when an association is insolvent. Further, evidence presented at trial indicated that the Bank Board has at least since 1954 consistently based its evaluation of the financial status of associations on financial data contained in so-called "Monthly Reports."[4] These reports contain entries for the total book value of an association's assets and its total liabilities. In view of the legislative history of § 1464(d)(6)(A)(i), the Bank Board's interpretation of that statute carries with it a very great presumption of validity.

We now examine each of plaintiffs' statutory construction arguments. Plaintiffs' first theory exploited an asserted ambiguity in the statutory term "obligations." An institution is insolvent under the statute if the "assets of an association are less than its obligations." Plaintiffs' first witness insisted that the term "obligations" was deliberately chosen instead of the word "liabilities" and that it has a narrower meaning than "liabilities." Obligations, the witness contended, are those liabilities that do not arise until the instant they are due and payable. The ramifications of this distinction, if it held water, were substantial. Time deposits, for example, comprised

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[2] Sen. Rep. No. 1472, 83rd Cong., 2d Sess., *reprinted in* [1954] U.S. Code Cong. & Ad. News 2723. A similar provision was contained in the Home Owner's Loan Act of 1933. *See* Fahey v. Malonee, 332 U.S. 245, 250-253 n. 1 (1947).

[3] *See* Sen. Rep. No. 1482, 89th Cong., 2d Sess., *reprinted in* [1966] U.S. Code Cong. & Ad. News 3532. Sen. Rep. No. 95-1273, 95th Cong., 2d Sess., *reprinted in* [1978] U.S. Code Cong. & Ad. News 9273.

[4] Tr. 1001 (Kenneth Scott).

a large percentage of Telegraph's portfolio. Only a fraction of these time deposits came due on May 22, the date Telegraph was placed in receivership. If holders of time deposits that were due after May 22 came in on that day to withdraw their money, they would suffer substantial penalties. Assuming all such depositors appeared at once on May 22, the Association's obligations would be by virtue of the penalties $2,850,000.00 less than if the certificates were held to maturity. Tr. 184. If these deposits are not considered "obligations" in their full amount as of May 22, Telegraph was solvent on that date by a whopping amount of $2.5 million.

The theory was discredited, however, by witnesses for both sides. First, it became apparent that "obligations" is treated within the accounting profession as a more general term than "liabilities"[5] and that while many "obligations" of a firm are not "liabilities," all "liabilities" are "obligations." Second, the same witnesses took issue with the proposition that obligations become such only at the instant they become due. Both generally accepted accounting principles and regulatory accounting principles require that books be kept on an accrual basis. That is,

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[5] A publication of the Financial Accounting Standards Board, "Statement of Financial Accounting Concepts No. 3" (December 1980), Defendants' Exhibit 6, states that liabilities "are future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." At 13. Obligations are defined in the same manual as follows: "Obligations is used with its usual general meaning to refer to duties imposed legally or socially to that which one is bound to do by contract, promise, moral responsibility. It includes equitable and constructive obligations as well as legal obligations." At 12 n. 14. The manual then compares "liabilities" with "obligations:" "Although most liabilities rest generally on a foundation of legal rights and duties, existence of a legally enforceable claim is not a prerequisite for an obligation to qualify as a liability if the future payment or other transfer of assets to settle the obligation is otherwise probable." At 13.

revenues and expenses are allocated at time periods to reflect an enterprise's performance during those periods rather than merely listing receipts and expenses at the moment they occur. Tr. 587. Counting as obligations only those debts that come due at a given moment is totally inconsistent with accrual accounting. Moreover, according to plaintiffs' theory, an association could be solvent one moment before crushing obligations became due and insolvent the moment after. Plaintiffs' theory would prevent the Bank Board from taking action until the fatal moment had passed. There is no reason to believe that Congress intended to hamstring the agency in this way.[6] Finally, Kenneth Scott, a former general counsel of the Bank Board, testified that the broader term "obligations" might have been used instead of "liabilities" because of the peculiar nature of savings and loan associations. In 1954, when the insolvency section of the receivership statute was passed, most associations were mutual; that is, they were owned by their depositors ("members") who were not considered creditors, had no legal right to interest, and no legal right to withdraw their money at will. *See generally Wisconsin Bankers Association v. Robertson*, 190 F. Supp. 90, 92 (D.D.C. 1960), *aff'd* 294 F.2d 714 (D.C. Cir. 1961), *cert. denied*, 368 U.S. 938. Mr. Scott testified that by using the broad term "obligations" the statute encompasses not only the obligations owed conventional creditors, but also the amounts due depositors.

Plaintiffs' second statutory construction argument also focuses on the term "obligations." Here, plaintiffs contended that Congress did not intent to charge an association with liabilities that are mere accounting entries the association will never have to pay. Plaintiffs point to two such items: deferred income taxes and deferred loan fees.

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[6] Additionally, it became clear at trial that if plaintiffs had similarly eliminated from the left side of the balance sheet those assets that were not due them precisely on May 22, 1980, they would still have been insolvent. Defendants' Exhibit 13.

Telegraph argues that deferred taxes should not have been considered since they had lost money in the past few years and would have continued to lose money in the future. Since it would have had no foreseeable income, the Association should not have been charged with deferred income taxes. However, the matter is not that simple. The fact that an association has a loss in a particular year does not determine what deferred tax entry is required on its balance sheet for that year. Under the applicable tax law, the effect of a loss in a particular year may not be known for several years. *See generally* Defendants' Exhibit 13, "Accounting Principles Board Opinion No. 11: Accounting For Income Taxes" (December 1967). Such a determination may be made only after extensive audit procedures. Again, we do not think Congress intended to stay the Bank Board's hand until its team of accountants wrestled with highly complex tax calculations.

Telegraph also argues that it should not have been "charged" with deferred loan fees. The argument implies that the unearned portion of the loan fees was treated as a liability of the association when it was in fact an asset. The simple answer to this is that the deferred loan fees were not treated as something the Association owed but rather as an offset to an asset. This correctly depicted the fact that the Association would earn its loan fee in increments over the life of the loan, not all at once in the year the loan was made.

We turn now to Telegraph's third statutory construction argument. Telegraph claims that "assets" should be read to mean "liquid assets" and "obligations" to mean those obligations coming due on a given day. This argument may be readily disposed of. The construction of "assets" and "obligations" proposed by Telegraph would radically alter the plain meaning of the statute. As it reads, the statute sets forth some fashion of net-worth or balance sheet definition of insolvency; that is, insolvency is determined simply by subtracting liabilities from assets. It is this definition that is used in the Bankruptcy

Code, 11 U.S.C. § 101(26) (1979).[7] Plaintiffs propose a liquidity or "equitable" definition of insolvency, such as that appearing in the old Bankruptcy Code, 11 U.S.C. § 205(a) (1976). Their argument presumes, of course, that Congress was unable to state explicitly the liquidity definition when it wanted to. The presence of the liquidity test in the old Bankruptcy Act and in a number of other statutes entirely destroys this premise. *See, e.g.*, Farm Credit Act of 1971, 12 U.S.C. § 2183(b) (1980); Securities Investor Protection Act Amendments of 1978, 15 U.S.C. § 78eee(b)(1)(A).

Moreover, it should be clear by now that in construing § 1464(d) the court will not embrace a construction that will hamper the Bank Board in the vigilant exercise of its authority to protect depositors and its insurance fund. Plaintiffs admitted at trial that an association could be in very bad shape financially, yet still be able to meet the liquidity test of insolvency.

We turn now to Telegraph's final challenge to the Bank Board's interpretation of the statute. Here Telegraph claims that the term "assets" must be read to mean "assets valued at fair market" rather than "assets valued at book."[8] Though this contention was somewhat longer lived than plaintiffs' previous three, we reject it also. Evidence at trial showed that in 1954 interest rates were so low that, for all practical purposes, book and market values for a mortgage were the same. It is doubtful, therefore, that Congress intended that one rather than the other method of valuation be employed. On the other

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[7] The Bankruptcy Code's definition differs from the one used by the Bank Board in that it values the assets of the bankrupt business at "fair value."

[8] Plaintiffs understandably hesitate to adopt this construction of the statute since the fair market value of an association will always be less than or equal to the book value. Nonetheless, there are only two ways to value assets, at book or at market. Plaintiffs' rejection of the book value test requires us to consider the other alternative.

hand, the Bank Board has valued assets at book since the statute was enacted and Congress has not seen fit to amend the statute to require the Bank Board to mark an association's assets to market. These two facts are very persuasive evidence that the Bank Board's construction is consistent with congressional intent.

Congress' failure to replace the book net worth test is particularly significant in light of the 1966 amendments to § 1464(d)(6). At that time, Congress completely overhauled the procedures by which receivers were appointed by the Bank Board. In the Senate Report to the bill, the committee expressly noted that a revision of paragraph (6) was needed to deal with the growing number of institutions that were failing because of the spiralling interest rates:

> Furthermore, the present monetary situation with the extraordinary demands for credit far outrunning the available supply, the resulting upward pressure on interest rates and the consequent compulsion to obtain high yields, often at the risk of loss—have imposed an unusual burden on all financial institutions. It is not surprising that there have been in recent months a few very substantial involuntary liquidations and a few forced mergers.

Senate Report No. 1482, 89th Cong., 2d Sess. (1966), *reprinted in* [1966] U.S. Code Cong. & Ad. News 3532 at 3536-3537. Thus, even though Congress was aware that the mortgage portfolios of many associations were falling behing the market, it did not see fit to compel the Bank Board to abandon the book valuation of assets.

The only evidence indicating that Congress intended that assets be valued at the fair market value was the testimony of Kenneth Scott, the former general counsel to the Bank Board. On direct examination, Mr. Scott assented to the proposition that assets were to be valued at book. On cross, he stated that the assets were intended to be valued at "fair value." When asked if this meant fair market value, he said that it did. On redirect, Mr. Scott attempted to clear up the confusion. Thus he explained that

> The Board's reporting rules have always been on the premise that the associations would report mortgage portfolio in the standard method, which means at book value. There are individual instances in which examiners have gone behind book values to try to ascertain real values, actual market values, and require write-downs. That is done on an individualized basis. It is not the standard practice whereby the associations prepare and report their financial statements.

Tr. at 1002.

We disagree with plaintiffs' contention that Mr. Scott's testimony demonstrates that the Board's construction of the term "assets" is clearly inconsistent with the congressional intent. What the evidence shows is that, at the time the statute was enacted, Congress was not particularly concerned with the distinction between book and fair market valuation of assets, that book value had been consistently used in accounting for the status of financial institutions, that it has been employed by the Board consistently for nearly 30 years save in certain instances in which writedowns have been required and that Congress has not amended the Act to change the Board's practice. Under these circumstances, we defer to the Board's construction of the statute.

III. Application of the Insolvency Test to Telegraph

It is our determination, then, that the statute declares an association insolvent when its obligations, including all its liabilities, are less than the book value of its assets (the "book net worth test"). We now examine whether Telegraph was insolvent according to this definition on May 22, 1980.

In our opinion of June 9, 1981, we explored the evidence of Telegraph's insolvency as of May 22, 1980. Our discussion there was based on the premise that the book net worth test controlled the case. Since that premise has now been confirmed, we simply review the evidence discussed in our earlier opinion.

From July 1, 1979, to April 30, 1980, Telegraph's book net worth steadily declined from nearly $5 million to $450,000.00. The operational losses for April 1980 alone exceeded $734,000.00. On May 19, Telegraph's comptroller made the following projection:

> Based upon my review of the books and records of Telegraph as of May 19, 1980 and taking into consideration my knowledge of the financial circumstances of Telegraph, I estimate that for the period May 1 through 19, 1980, Telegraph had lost $591,778.29 and I projected that for the entire month of May, Telegraph would lose $983,147.86.

Conover Affid., ¶3 (8-26-80). On the basis of the projections of Telegraph's own comptroller, Telegraph had a negative book net worth of approximately $142,000.00 on May 19 and of approximately $240,000.00 on May 22. We note that Telegraph's treasurer estimated that, on the basis of April's operating loss, the Association had a negative net worth of $89,000.00 on May 22, 1980. Seely Affid., ¶15 (8-26-80).

In our opinion on defendants' summary judgment motion, we observed that the book net worth figures up to May 1, 1980, were not disputed. We stated, however, that the Bank Board's projection that Telegraph would have had a negative book net worth on May 22, 1980, was open to question. We also held that the burden of proving that the projection was unreasonable lay upon the plaintiffs. As noted above, however, at trial plaintiffs chose not to attack the reasonableness of the Bank Board's projection of Telegraph's book net worth, but rather the concept of book net worth itself. Defendants successfully repelled plaintiffs' attack on the book net worth test. We now find, in light of plaintiffs' failure to present evidence showing that the Bank Board's projection that Telegraph had a negative book net worth on May 22, 1980, was unreasonable, that the Bank Board's projection was reasonable and that Telegraph was insolvent within the meaning of § 1464(d)(6)(A)(i).

IV. Constitutional Challenge of § 1729(c)(2)

As Telegraph's attacks on the Bank Board's application of the statute have been of increasing generality, it is appropriate that their final argument is directed at the constitutionality of the receivership. It is important at the outset to identify the constitutional objections that Telegraph is *not* making. First, it does not claim that the Bank Board's action constituted a taking of property within the meaning of the Fifth Amendment. Plaintiffs' remedy for a taking is, of course, just compensation. The fair market value of Telegraph's assets, however, was somewhere in the area of negative $30 million.[9] Nor does Telegraph argue that the receivership was a violation of the Contract Clause. That Clause only guarantees against government conduct that impairs contracts, not that which is intended to preserve them.

Rather, it is Telegraph's claim that § 1464(d)(6)(A)(i), which is incorporated by § 1729(c)(2)(B), was applied by the Bank Board in a manner that violated substantive due process. The argument is as follows. The Bank Board took custody of Telegraph under 12 U.S.C. § 1729(c)(2), the statute that gave the Bank Board power to obtain custody over *state* chartered savings and loan associations. The only reason Congress extended the Bank Board's power to receive the assets of state associations was to enable it to protect the assets of the Federal Savings & Loan Insurance Corporation. As we stated at pages 12-13 of our opinion of June 9, 1981, until 1968 the FSLIC was primarily liable on depositors' claims against failing associations but it was seldom given control over the association's assets. Rather, control remained with a state receiver who was not responsible to the federal agency. Section 1729(c) was intended to protect the funds of the FSLIC from dissipation in the hands of a state receiver. Telegraph argues that the Bank Board's test for taking custody of an association under § 1729(c) must be related

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[9] Statement of plaintiffs' counsel at final argument, Tr. 21 (January 7, 1982).

to the risk that the association poses to FSLIC's insurance fund. If the receivership criteria do not tell the Board when an association puts the insurance fund at risk, then it is irrational and violative of substantive due process.

Now, says Telegraph, § 1729(c)(2)(B) provides that the Bank Board may take custody of an association if one or more of the grounds specified in § 1464(d)(6)(A) existed. One of these grounds is that the association is insolvent or, according to the Bank Board, that the association have a negative book net worth. It is Telegraph's contention that the negative book net worth test bears absolutely no relation to the purpose of § 1729(c), namely, safeguarding the FSLIC's insurance fund; that is, the mere fact that an institution has a negative book net worth is *no indication whatsoever* that the association imperils FSLIC's insurance fund.

Telegraph claims that the risk to FSLIC's insurance fund can only be gauged by an insolvency formula that is based on the *fair market value* of the failing association. When the FSLIC is appointed receiver of an association, its exposure is equal to the amount that the depositors claim over and above the amount the agency will receive from the liquidation. FSLIC has no choice but to liquidate or sell the association on the open market at its fair market value; thus, the amount of money it will have to pay depositors—that is, the amount by which its funds will be put at risk—can only be determined with reference to the fair market value of the association.

Plaintiffs illustrate the point with a chart showing the book net worth and fair market value of a number of savings and loan associations operating in Chicago. Plaintiffs' Supplemental Post-Trial Brief, Exhibit B. This chart shows that the associations that have the smallest book net worth have the largest fair market net worth and the associations that have the largest book net worth have the smallest fair market net worth.[10] For example,

[10] The following is a sample of every fourth institution appearing on plaintiffs' chart:

(Footnote continued on following page)

Morgan Park Savings & Loan has a book net worth of $23,000.00 and a fair market net worth of negative $569,000.00. Talman Savings & Loan has a book of $112,268,000.00 and a fair market net worth of negative $660,237,000.00. The conclusion Telegraph draws from this chart is that, upon liquidation, those associations with a higher book pose greater risks to FSLIC's insurance fund. In plaintiffs' words,

> [T]he agency's test does not tell the agency when their insolvency risk begins, it does not identify the institutions which pose the insolvency risk, and it

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[10] *continued*

	BOOK NET WORTH	BOOK ASSETS	FAIR MARKET NET WORTH
Morgan Park	23	2,958	(569)
Ft. Dearborn	800	28,646	(4,929)
Allied	1,824	32,516	(4,679)
Central	2,872	70,468	(11,222)
Archer	4,599	42,280	(3,857)
Second	7,170	101,560	(13,142)
Liberty	19,145	259,393	(32,734)
Talman	112,268	3,682,527	(660,237)

(All figures above are in thousands of dollars). The fair market net worth is calculated by discounting the book value of the assets by 20 per cent. Testimony at trial indicated that, at the going interest rates, the discount is between 20 per cent and 30 per cent.

Since fair market net worth is calculated merely by discounting at a fixed rate the book value of an association's assets, those associations with greater book assets will have a greater discount and therefore a smaller fair market net worth. Thus, it should be noted that the rankings of the associations according to book assets and book net worth are virtually identical: The association having the smallest book assets has the smallest book net worth and the association having the greatest book assets has the greatest book net worth.

It is also worth noting that the book value of an association's assets is not a randomly selected figure. The assets of a savings and loan association consist primarily of home mortgages and the book value of these mortgages represents the principal that the mortgagor must eventually repay.

> does not tell them the extent of the insolvency risk posed. It is a truly meaningless comparison of assets and obligations as far as their funds is concerned.

Plaintiffs' Supplemental Post-Trial Brief, p. 12.

Before we evaluate this argument, we briefly discuss the standard of review in substantive due process cases. In order to survive a substantive due process challenge, the government need only show that the statute is "rationally based and free from invidious discrimination." *Richardson v. Belcher*, 404 U.S. 78, 81 (1972), *quoting Dandridge v. Williams*, 397 U.S. 471, 487 (1970). Long ago, Justice Brandeis, in a dissent that has now received the approval of the Court, *see Breard v. City of Alexandria*, 341 U.S. 622, 632-633 (1951), described the role of federal courts in substantive due process cases:

> Our function is only to determine the reasonableness of the legislator's belief in the existence of evils and in the effectiveness of the remedy provided. In performing this function we have no occasion to consider whether all the statements of fact which may be the basis of the prevailing belief are well-founded; and we have, of course, no right to weigh conflicting evidence.

New State Ice Co. v. Liebman, 285 U.S. 262, 286-287 (1932). More recently, the Court has stated that

> [T]he judiciary may not sit as a superlegislature to judge the wisdom or desirability of legislative policy determinations made in areas that neither affect fundamental rights nor proceed along suspect lines (citation omitted); in the local economic sphere, it is only the invidious discrimination, the wholly arbitrary act which cannot stand consistently with the Fourteenth Amendment.

427 U.S. 301, 303-304 (1976).[11]

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[11] The same standard applies to substantive due process claims brought against the federal government under the Fifth Amendment as applies to claims brought against the states under the Fourteenth. Richardson v. Belcher, 404 U.S. 78 (1972).

Plaintiffs argue that a higher standard of review is warranted in this case since it "concerns fundamental constitutional rights such as the right of contract and the right of property ownership." Plaintiffs' Supplemental Post-Trial Brief at 19. This is not the law. The Supreme Court has over the years identified a number of "fundamental rights" which, when implicated by an act of government, trigger heightened judicial scrutiny. Among such rights are the rights to association, *N.A.A.C.P. v. Patterson*, 357 U.S. 449 (1958); to travel, *Shapiro v. Thompson*, 394 U.S. 618 (1969); to vote, *Harper v. Virginia Board of Elections*, 383 U.S. 663 (1966); to fair criminal process, *Douglas v. California*, 372 U.S. 353 (1963); and to privacy, *Roe v. Wade*, 410 U.S. 113 (1973). The right to do business has never been considered a fundamental right. On the contrary, in a number of cases, the Supreme Court has held that the government may regulate or even *prohibit* an occupation or business without running afoul of the Due Process Clause, provided that the law bears a rational relation to a legitimate purpose.[12] *New Orleans v. Dukes*, 427 U.S. 297 (1976) (upheld law prohibiting street vendors in portions of the city); *Ferguson v. Skrupa*, 372 U.S. 726 (1973) (upheld law prohibiting debt adjustment except by lawyers); *Williamson v. Lee Optical of Oklahoma*, 348 U.S. 483 (1955) (upheld law prohibiting sale of prescription glasses by optometrist without a prescription); *Breard v. City of Alexandria*, 341 U.S. 622 (1951) (upheld statute forbidding door-to-door solicitation). In each of these cases, government action drove persons from their businesses and, more likely than not, disturbed numerous contractual relationships. Nonetheless, the government's action was subject only to a rational basis test. Moreover, the scope of the disturbance—whether it is the hot dog vendor in New Orleans who must surrender his pushcart or

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[12] In Ferguson v. Skrupa, 372 U.S. 726, 732 (1963), the Supreme Court stated that for substantive due process purposes it was neither "able [nor] willing to draw lines by calling the law 'prohibitory' or 'regulatory'."

the banker in Chicago who must part with a financial empire—is, of course, no consequence under the Due Process Clause.

This point was forcefully made in *U.S. v. Central Eureka Mining Co.*, 357 U.S. 155 (1958). In 1942, the government, in an action that came extremely close to the nationalization of an industry, ordered all non-essential gold mines to close down in order to free the machines for war-related work. Central Eureka sued on the theory that the order constituted a taking for which it was entitled to compensation and on the theory that the law violated substantive due process. In a decision that is more noteworthy for its holding that no taking had occurred, the Court also held that the law was rationally related to a legitimate government objective and, thereby, passed constitutional muster. If substantive due process challenge to government action that effectively took control over the deployment of the assets of a business is evaluated by the rational basis test, we doubt that a stricter standard of review is warranted in this case.

We conclude, then, that the Bank Board's application of § 1729(c)(2) must be judged under the rational basis test.[13]

It is the court's opinion that plaintiffs have failed to show that the book net worth test is a "wholly arbitrary" or irrational means to protect FSLIC's insurance fund.

First, book net worth includes not only the book value of an association's assets, but also the amount of capital

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[13] At final argument the court suggested that under the traditional rational basis test, plaintiffs would have to prove that the legislation bears no *conceivable* rational relationship to a legitimate government objective. *See, e.g.*, U.S. Railroad Retirement Board v. Fritz, 449 U.S. 166, 179 (1981). Plaintiffs hotly dispute the application of this standard, particularly where the legislative history states what Congress thought the relationship was. In view of our finding, *infra*, that the legislation is rationally related to the objectives *in the way Congress intended*, we need not resolve the question of the applicability of the more deferential standard to this case.

invested by the owners. In any business, the owners' interest is that which is left after deducting the total obligations from the total assets. The figure that remains is the net worth and it is, in a very real way, the owners' stake in the business. As defendants point out, when net worth is used up, the owners have lost their stake in the business and they continue in business only by gambling with the depositors' money, hoping that at some point the losses will reverse and their equity will be restored. But the depositors are of course insulated from loss by the FSLIC insurance fund. Thus, when book net worth sinks below zero, the real gambler is the FSLIC.

The variance between book net worth and fair market net worth illustrated by plaintiffs' chart loses much of its punch when we focus not on the extent of risk to the FSLIC's fund *upon liquidation*, but on the economic indicia that intervention is warranted. Here, the Bank Board, like the accounting profession traditionally, has chosen to rely exclusively on book net worth figures. Insofar as these figures bear a relationship to the owner's equity in the business, we cannot say that the Bank Board's test—as a test for determining *when to intervene*, rather than a test for determining the *cost of intervention*—is irrational. The Bank Board's test is based on the age-old adage that a person is more careful with his own money than he is with his neighbor's. While this thinking may not hold true in all cases, it is undeniably rooted in experience.

As an indicator of financial instability, we note that the negative book net worth test is far more favorable to the institution than the negative fair market value test. As plaintiffs' chart illustrates, most associations currently have a negative fair market value; only a very few have a negative book net worth. These latter associations are distinguished from other associations in that they have experienced larger operating losses.[14] While

[14] Telegraph, for example, had experienced in March of 1980 operating losses of $2.58 per $100.00 of assets which proved to

(Footnote continued on following page)

operating losses may not tell the Bank Board much about an association's ability to weather a short financial squall, the persistence of such losses over time is indisputably relevant to any evaluation of an association's long-term fitness. Insofar as the negative book value test reflects the trends of an association's operating losses, we cannot say that it bears no rational relation to the preservation of FSLIC assets.

Second, evidence was presented indicating that the financial community at large attaches significance to book net worth figures. We refer particularly to the deposition of Jay Janis, the former Chairman of the Bank Board.[15] Plaintiffs undoubtedly disagree with Mr.

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[15] *continued*
be $2.87 or 990 per cent behind the class of associations to which it belonged. For the 12 months ending in March of 1980, Telegraph was 447 per cent behind its class in operating results. Defendants' Exhibit 16.

[15] The deposition of Jay Janis contains the following colloquy:

A. . . . Insolvency to me is something in the market place will soon lead to inability to meet obligations.

Q. Can you explain to me what you mean by that?

A. Yes. When an association runs out of new worth or even when it is close to running out of net worth, it is in a difficult position. The association has to deal with a number of factors and elements in the outside world.

For instance, it has to deal with the investment banking community in Wall Street. That community is keyed in helping the institution to obtain large certificates of deposit, jumbo certificates as they are known in the industry, over $100,000.

The institution also has to deal with creditors. These creditors are concerned about the financial health of an institution.

An institution also has to deal with its depositors, those who place savings at an institution and rely on its financial condition for continuing to make such deposits.

An institution also raises funds through outside borrowings and those who are lenders, relying on institutions' financial condition. Likewise, an institution deals with a whole set of dealers in the business community and in the financial world who also look to their financial condition.

(Footnote continued on following page)

Janis' comments. It is critical, however, to bear in mind that we are analyzing this case for its substantive due process defects. As the Supreme Court has stated, "The day is gone when this Court uses the Due Process Clause of the Fourteenth Amendment to strike down state laws, regulatory of business and industrial conditions, because they may be unwise, improvident, or out of harmony with a particular school of thought." *Williamson v. Lee Optical Co.*, 348 U.S. at 488; *Dandridge v. Williams*, 397 U.S. 471, 484 (1970). The sentiment expressed in *Lee Optical* is no less applicable to a challenge based on the Fifth Amendment Due Process Clause. In either case, a court's deference is based on the institutional inability of a court to choose between competing economic theories. If anything is clear from the last two decades in this country, it is that economic

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[15] *continued*

Now, the key issue for all of them is the issue of the insolvency of the association and net worth of the association is absolutely central to their determination about the financial condition of an institution.

So when an institution is reaching insolvency or in fact has reached it, it is my judgment that those sources of funds that they normally would look to and that I have previously mentioned are circumscribed by the financial condition, i.e., the lack of net worth.

Q. So that if an institution—I am trying to relate the discussion back now to the subject I raised before, the ability or inability of an institution to meet the obligations when it came due. So if an institution, in your view, is at or near zero net worth situation, then it also can be characterized as being very close to a situation where it would be unable to meet its obligations as they become due; is that accurate?

A. It will be unable to obtain further funds and an institution which cannot obtain funds is an institution that can't operate.

Q. But what if an institution had a zero or a negative net worth and was still able to obtain funds. Would you characterize that institution as insolvent?

A. Yes.

Deposition of Jay Janis at 69-70 (August 10, 1981).

theories are far from certain. In such circumstances, it is particularly appropriate that this court refrain from second-guessing the agency that has been recognized by Congress as possessing a certain amount of expertise in a complex field.

Finally, we hold that the book net worth test has some relationship to the preservation of public confidence. For tactical reasons that are obvious, plaintiffs have sought to focus the court's attention on only one purpose of the receivership statute, i.e., the protection of the integrity of FSLIC's insurance fund. They have based their constitutional challenge on the premise that this was the only purpose served by § 1729(c).[16] But at the time Congress enacted § 1729, it recognized that the integrity of FSLIC's funds and preservation of public confidence in savings and loan associations were intertwined:

> Federal insurance of savings accounts is fundamental to the financial stability of the entire savings and loan industry. The home building industry and millions of American home buyers depend upon savings and loan associations to help finance the construction and purchase of homes. The public has placed more than $120 billion of its savings in insured savings and loan associations. The ability of the savings and loan industry to help meet the Nation's housing needs would not have been possible without the public being confident that their savings were safe and secure. Much of the credit for maintaining this public confidence must be attributed to the savings account insurance pro-

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[16] In our opinion of June 9, 1981, we identified the protection of FSLIC's insurance fund as the main purpose of § 1729(c). But, as the legislative history quoted *infra* indicates, the preservation of public confidence is inseparable from the integrity of the FSLIC's assets.

> vided by the Federal Savings and Loan Insurance Corp.

Senate Report No. 1263 at 2535-2536.

It is also evident from the legislative history of § 1464 (d)(6)(A), which is incorporated into § 1729(c), that federal receiverships were generated, at least in part, by the need to preserve the public's confidence in financial institutions. In the Senate Report to the 1954 amendment of § 1464, it was stated:

> The vital importance of sound and effective systems of banks and savings and loan associations to the continued economic growth of the country is clear. The banking system is a fundamental part of our monetary system and the Nation's $130 billion of demand deposits represents the principal element of the Nation's money supply. Banks and savings and loan associations are among the principal financial intermediaries of the Nation, holding about $300 billion in savings and channeling some $30 billion of new savings each year into homebuilding and other productive fields.

Senate Report No. 1482 (August 18, 1966) 89th Cong., 2d Sess. at 3536, *reprinted at* 1954 U.S. Code & Ad. News 3532, 3536. Inasmuch as the Senate Committee recognized the importance of the accumulation of deposits, it recognized the importance of maintaining the public's belief that its savings were secure. Section 1464 (d)(6)(A) and, therefore, § 1729(c) were intended, at least in part, to preserve the public's confidence.

The Bank Board's use of the book net worth approach to insolvency is rationally related to the preservation of the public's confidence. Mr. Janis' deposition testimony quoted above indicates that the public is likely to pay considerable attention to net worth figures in determining whether to deposit money in an association. It is also possible that the public would lose confidence in the watchdog agencies if it became known that the agencies

did not take seriously a substantial impairment of an association's net worth. Moreover, should the public lose confidence in a particular association, the big loser would be the FSLIC. As the flow of deposits stop, the association will have less money to work with and will become less credit worthy. The more the association's position deteriorates, the more likely it is that the FSLIC will be called upon to pay.

For these reasons, we find that § 1729(c) as applied by the Bank Board was neither arbitrary nor irrational. The most that may fairly be said about the Bank Board's conduct in this case is that it may have proceeded from an over-abundance of caution. Many persons, including those members of Congress who gave the Bank Board virtually a free hand in regulating the field, may believe that there can never be enough caution when other people's money is on the line. This appears to be what the legislators had in mind when they stated in 1966 that:

> The continued economic growth of this country is clearly dependent upon the existence of financially sound and capably managed private lending institutions . . . In such cases (in which institutions are improperly managed), it is essential that the Federal supervisory agencies have the statutory and administrative facility to move quickly and effectively to require adherence to the law and cessation and correction of unsafe or improper practices.

Senate Report No. 1482 at 3536.

In the absence of the Bank Board's use of arbitrary or irrational standards, this court will not interfere with the agency's exercise of its delegated authority.

We therefore find against plaintiffs in their action to remove the receiver appointed by the Bank Board and

enter judgment for defendants on Count III of the complaint.[16]

DATED: February 19, 1982

ENTER: /s/ JOHN F. GRADY
United States District Judge

[17] Count V of the Second Amended Complaint charges William J. Schilling, the Commissioner of Savings and Loan Associations for the State of Illinois with conspiracy to violate the federal statutes, 12 U.S.C. §§ 1464(d)(6)(A) and 1729(c)(2). Since we have found that neither of these statutes were violated in connection with the receivership of Telegraph, judgment in favor of William J. Schilling will be entered on Count V.

APPENDIX G

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 80 C 2792

TELEGRAPH SAVINGS AND LOAN ASSOCIATION,

Plaintiff,

v.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION, et al.,

Defendants.

MEMORANDUM OPINION

Plaintiff brings this action to remove the Federal Savings & Loan Insurance Corporation ("FSLIC") as receiver of its assets and to obtain equitable relief for harm suffered as a result of the sale of those assets. Before the court is the motion for summary judgment of defendants Federal Home Loan Bank Board ("FHLBB") and FSLIC on Count III. The motion is granted in part and denied in part.

I. FACTS

The uncontroverted facts are as follows. Telegraph Savings and Loan Association ("Telegraph" or "the Association") was a state chartered, federally insured savings and loan association. Several years prior to 1980, Telegraph began experiencing financial difficulties as a result of an adverse "spread" between the yield

on its portfolio mortgages and the rising cost of money. Strasser Affid., ¶3. As a federally insured association, Telegraph was required by law to maintain reserve and net worth requirements as set forth in 12 C.F.R. § 563.13. In 1977 and again in 1978, it met these requirements only by earmarking paid-in surplus from the issuance of preferred stock. Roy Affid., ¶2. As of June 30, 1979, Telegraph failed to meet its minimum reserve requirement by $303,480.00 and had fallen short of its net worth requirement by $704,513.00. *Id.* For the six months ending June 30, 1979, the Association suffered losses in excess of $650,000.00 and logged a total loss for 1979 of $237,469.00. *Id.*, ¶3. As of June 30, 1979, Telegraph's net worth was set at $4,806,938.00. *Id.*; Conover Affid., Ex. 3 (8-26-80). Over the following ten months, Telegraph's net worth steadily declined to an April 30, 1980, level of $449,389.[1] Roy Affid., ¶¶3, 4; Conover Affid., Exhs. 2-13. In the month of April 1980 alone, the Association lost over $730,000.00. Conover Affid., Ex. 13. Telegraph's daily operational losses accelerated from $15,500.00 per day in February to $18,700.00 in March to $24,500.00 in April.

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[1] Telegraph's monthly losses and declining net worth from July 1979 through April 1980 were as follows:

Date	Income or Loss for Month	Net Worth
7/01/79		4,806,938
7/31/79	(435,915)	4,371,023
8/31/79	(366,695)	4,004,328
9/30/79	(291,348)	3,712,980
10/31/79	(315,479)	3,397,501
11/30/79	(345,726)	3,051,775
12/31/79	(255,843)	2,780,283
1/31/80	(561,442)	2,218,841
2/29/80	(455,074)	1,763,767
3/31/80	(579,454)	1,184,313
4/30/80	(734,924)	449,389

Conover Affid., ¶1-13 (8-26-80).

As a result of its financial difficulties, late in 1979 Telegraph became the subject of careful scrutiny by the Illinois Commissioner of Savings and Loan Associations ("the Commissioner"), the FHLBB and the FSLIC. As a result, a special meeting of Telegraph's Board of Directors was called on December 20, 1979, and was attended by the Deputy Commissioner of Savings and Loan Associations. At this meeting, Telegraph's president, William Strasser, reviewed the position of the Association and concluded that it "clearly was undercapitalized." Strasser also stated that various plans for the infusion of new capital were under consideration, including the sale of $3 million of preferred stock to a publicly held corporation. Nelson Affid., Ex. 2. The Deputy Commissioner responded that if Telegraph's financial condition did not improve by March 31, 1980, the Commissioner would have to consider taking custody of the Association. *Id.*

Another special meeting of the Board was held on March 5, 1980, and was attended by the Commissioner who presented a number of resolutions intended to prevent the Association's financial demise. The minutes report that merger possibilities were discussed in detail. Nelson Affid., Ex. 3. The Commissioner stated that if no buyers appeared by March 31, 1980, he would be compelled to proceed with custody.

In the meantime, Telegraph's position had continued to deteriorate. On May 19, 1980, Telegraph's comptroller prepared reports projecting losses of over $590,000.00 for the period of May 1 to May 19 and losses of nearly $1 million for the entire month. Conover Affid., ¶3 (8-26-80). These losses, were they actually to occur, would have given Telegraph a substantial negative net worth by mid-May. It appeared that Telegraph would in fact suffer these losses when, on May 21, 1980, Virgil Seeley, Telegraph's executive vice-president and treasurer, informed the Commissioner that, "Nothing has come to my attention that would indicate operating

results materially more favorable for May, 1980 than those experienced in April, 1980." Seeley Affid., ¶3 (8-26-80).

In early May, Strasser finally came up with a buyer for the Association. Strasser obtained a written commitment from The Heron Corporation to purchase 80 per cent of Telegraph's preferred stock for $7 million. The deal was conditioned, however, on FSLIC's promise to provide Telegraph with a 15-year, $15 million interest-free loan, to be extended for an additional five years at six per cent interest. This proposal was evaluated by the FHLBB at a closed meeting on May 22 and rejected for two reasons: First, it was thought to provide insufficient capital to turn the Association around and second, it appeared that a sale of the assets would prove more costly to the FSLIC than other alternatives under consideration.[2] Compilation of Materials Filed by FHLBB in Support of Motion for Summary Judgment, "Certified Transcript," pp. 6, 16, 22-26. At this meeting, it was also decided that when the State Commissioner took custody of Telegraph, the FHLBB would, pursuant to its statutory authority,[3] appoint FSLIC receiver and immediately transfer the assets and liabilities to First Federal Savings & Loan Association under a purchase and assumption agreement. *Id.*

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[2] Joseph Arendes, a FHLBB staff member, submitted a written recommendation to the Board urging that the Heron proposal be accepted. Arendes has since stated that the memo was "anticipatory . . . [and] solely my conjecture which neither then nor later had any basis in fact." Arendes Affid., ¶ 4. Plaintiff has offered expert testimony to the effect that the proposal was sound and would have turned Telegraph into a profitable operation. Shapiro Affid., (4-9-81). The Board found, however, that the cost to the FSLIC to the Heron proposal was $3 million greater than the cost of transfering the business to another savings and loan institution under a purchase and assumption agreement. Compilation of Materials Filed by FHLBB in Support of Motion for Summary Judgment, "Certified Transcript" at 6.

[3] Title 12 U.S.C. § 1729(c)(2).

Later in the day, without giving prior notice, the Commissioner took custody of Telegraph.[4] The Commissioner's custody notice stated that Telegraph's withdrawal capital and permanent capital reserve were impaired; that it was unable to continue operations; and that its financial condition constituted an emergency, thereby excusing the Commissioner from giving Telegraph prior notice and an opportunity for corrective action.[5] Complaint, Ex. A. Moments later, the FHLBB's order appointing FSLIC receiver went into effect. The order stated the following grounds for the receivership:

> Telegraph is in an unsafe and unsound condition to transact business in that the association's losses have placed Telegraph in a condition of insolvency or imminent insolvency;

Complaint, Ex. B. The final act of the drama took place later that evening, when the FSLIC, as receiver, executed the purchase and assumption agreement with First Federal Savings & Loan Association. By the end of May 22, 1980, Telegraph had ceased to exist.

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[4] The Commissioner took custody of Telegraph pursuant to Ill. Rev. Stats. ch. 32, § 848 which provides that

> The Commissioner in his discretion may take custody . . . if it appears from reports made to the Commissioner, or from examination made by or on behalf of the Commissioner: . . . (b) That the withdrawable capital of the association is impaired to the extent that the realizable value of its assets is insufficient to pay in full its creditors and holders of its withdrawable capital; or that its permanent reserve capital is impaired; or (c) That the association is unable to continue operation; . . . ."

[5] Ill. Rev. Stats. ch. 32, § 848, provides that "[u]nless the Commissioner finds that an emergency exists which may result in loss to members or creditors and requires that he take custody immediately, he first shall give written notice to the directors, trustees, or liquidators specifying the conditions criticized and state a reasonable time within which correction may be made."

II. DISCUSSION

On June 3, 1980, the Association filed a ten-count complaint against a number of parties, including the Illinois Commissioner, the FHLBB and the FSLIC. Count III, attacking the legality of the receivership, is the keystone of the complaint, as a brief survey of the federal statutory framework demonstrates.

Title 12 U.S.C. § 1464(d) and § 1729 contain the provisions governing the appointment of federal receivers for state savings and loan associations and challenges to such appointments. With respect to challenges to a receivership, § 1464(d)(6)(A) provides that

> In the event of such appointment [of a receiver], the association may, within thirty days thereafter bring an action in the United States district court for the judicial district in which the home office of such association is located . . . for an order requiring the Board to remove such conservator or receiver, and the court shall upon the merits dismiss such action or direct the Board to remove such conservator or receiver.

Suit under § 1464(d)(6)(A) is the only means of attacking the legality of the conduct of a receivership, as § 1464(d)(6)(C) makes clear:

> Except as otherwise provided in this subsection, no court may take any action for or toward the removal of any conservator or receiver, or, except at the instance of the Board, restrain or affect the exercise of power or functions of a conservator or receiver.

Plaintiffs argue that if the court finds that the receiver was unlawfully appointed, a full panoply of equitable relief should be available to set aside the sale of assets.[6] Nonetheless, the parties do agree that if plaintiff does

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[6] Plaintiff seeks this equitable relief in Counts IV, VI, VII, IX and X.

not prevail under § 1464(d)(6)(A), all other causes of action challenging the appointment and conduct of the receiver must be dismissed.

We turn then to the law governing the appointment of receivers under Title 12. Section 1729(c)(2) provides the FHLBB with "exclusive power and jurisdiction" to appoint the FSLIC receiver for the assets of an insured state savings and loan association in the event the Board determines:

> (A) that . . . (ii) an insured institution (other than a Federal savings and loan association) has been closed by or under the laws of any State;
>
> (B) that one or more of the grounds specified in paragraph (6)(A) of section 1464(d) of this title, existed with respect to such institution at the time a conservator, receiver, or other legal custodian was appointed, or at the time such institution was closed . . . ; and
>
> (C) that one or more of the holders of withdrawable accounts in such institutions is unable to obtain a withdrawal of his account, in whole or in part;

Section 1464(d)(6)(A), referred to in subsection (B) of the foregoing statute, provides that

> The grounds for the appointment of a conservator or receiver for an association shall be one or more of the following:
>
> > (i) insolvency in that the assets of the association are less than its obligations to its creditors and others, including its members;
> >
> > * * * * *
> >
> > (iii) an unsafe or unsound condition to transact business;
>
> * * * * *
>
> The Board shall have exclusive power and jurisdiction to appoint a conservator or receiver. If, in

> the opinion of the Board, a ground for the appointment of a conservator or receiver as herein provided exists, the Board is authorized to appoint ex parte and without notice a conservator or receiver of the association.

The legality of the receivership turns on whether these three requirements set forth in § 1729 existed at the time of the appointment.

Before we apply this law to the facts of the case, however, it is necessary to establish the proper role of this court in reviewing the appointment of federal receivers for savings and loan institutions. As discussed above, § 1464(d)(6)(A) allows an association to challenge a receivership within 30 days after the appointment. The statute instructs that "the court shall upon the merits dismiss such action or direct the Board to remove such conservator or receiver."

The parties differ as to the court's role in this rather arcane proceeding prescribed by the statute. Defendants argue that the statute authorizes a limited review in which "the court must defer to the regulators on matters of policy and judgment, . . . determining [only] whether the basic prerequisites for administrative action have been satisfied." Def.'s Memo. In Support of Summary Judgment, 14. Plaintiff contends that the language "on the merits" requires the court to conduct a *post facto* adversarial hearing in which the "reasonableness" of the government's action is independently evaluated. Summary of Pl.'s Response to Def.'s Summary Judgment Motion, 3.

We agree with plaintiff that it is entitled to a full adversarial hearing "on the merits" of the case. This conclusion is compelled by the structure of the statute, by the legislative history and by the strictures of due process. We begin with the statute itself. Section 1464 (d)(6)(A) entitles the FHLBB to seize control, *ex parte*, of a savings and loan association if, in its opinion, seizure is warranted. The Board is required neither to

make findings nor to give reasons for its action. Rather, the first hearing accorded an association is in the district court and it is at this hearing that Congress apparently intended that such findings and reasons would emerge. That the hearing is to be "on the merits" suggests that the plaintiff is entitled to a more expansive review than that mandated by statutes requiring hearings "on the record." 5 U.S.C. § 706(2)(E) (review "on the record" authorizes court only to determine whether the decision is "unsupported by substantial evidence."); *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 414 (1970). In defining our proceeding as one "on the merits," rather than one "on the record," the statute seems to require not an appellate-type proceeding but rather an exercise of this court's *de novo* jurisdiction. *See Stoner v. Presbyterian University Hospital*, 609 F.2d 109, 112 (3rd Cir. 1979). Finally, that the agency action is to be tested in an expedited hearing evidences Congressional recognition of the significance of the due process interests involved in an ex parte seizure of property. In view of the significance of these interests, it would be anomolous to conclude that Congress intended to confine the court to a limited review of the seizure.

The legislative history of § 1464(d)(6)(A) reinforces this conclusion. Prior to 1966, the FHLBB could not appoint a receiver without first conducting a hearing at which the subject association had the opportunity to introduce evidence and cross examine.[7] In 1966, Congress gave the Board the power to appoint a receiver *ex parte* and without notice. In so doing, however, Congress substituted for the prior hearing an expedited hearing to be held in federal district court after the receiver had taken custody. Defendants have introduced no evidence from the legislative history—nor have we found any—which indicates that Congress intended to deprive an association of the right to contest the receivership in at least one full adversary hearing.

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[7] The legislative history appears in S.Rep. No. 1263, 90th Cong., 2d Sess. *reprinted in* 1968 U.S. Code & Ad. News 2530.

Moreover, providing an association with anything less than an adversarial hearing in the wake of an *ex parte* seizure offends the principles of due process. "Temporary governmental action against a particular party may often be taken without prior hearing if opportunity for full hearing is provided within a reasonable time." 2 Davis, *Administrative Law Treatise* 388 (2d ed. 1979); *see, e.g., Matthews v. Eldridge*, 424 U.S. 319 (1976); *North American Cold Storage Co. v. City of Chicago*, 211 U.S. 306 (1908); *Lawton v. Steele*, 152 U.S. 133 (1894). "In almost every setting where important decisions turn on questions of fact, due process requires an opportunity to confront and cross examine adverse witnesses." *Goldberg v. Kelly*, 397 U.S. 254, 269 (1969). The question presented to the court in the instant case raises important due process interests which can be resolved only through a detailed exploration of factual matters, viz., whether Telegraph was insolvent or in an unsafe and unsound condition at the time it was committed to a receiver.

While we therefore find that plaintiff is entitled to a *de novo* hearing "on the merits,"[8] we also agree with defendants that the "merits" are limited to the issue of whether the Board had statutory authority to appoint the FSLIC receiver. We are concerned in this proceeding not with the reasonableness or wisdom of the Board's conduct, but only with the question of whether the require-

[8] We wish to emphasize that our finding that a *de novo* hearing is required is based not on any provision of the Administrative Procedure Act, 5 U.S.C. §706, but on the provisions of 12 U.S.C. § 1464(d)(6)(A). The Supreme Court has stated that the APA authorizes *de novo* review only ". . . when the action is adjudicatory in nature and the agency factfinding procedures are inadequate. And there may be independent judicial factfinding when issues that were not before the agency are raised in a proceeding to enforce nonadjudicatory agency action." Citizens To Preserve Overton Park v. Volpe, 401 U.S. 415 (1970). Since we rely on § 1464(d)(6)(A) for the requirement of *de novo* review, we need not determine whether such review would also be allowed under 5 U.S.C. § 706.

ments of § 1729(c)(2) existed at the time Telegraph passed into receivership. Whether the Board should be able to take such action once those requirements have been met is one of those "fundamental policy questions appropriately resolved by Congress . . . [which] are not subject to re-examination in the federal courts under the guise of judicial review of agency action." *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council*, 435 U.S. 519, 558 (1977); *see also Radio Corporation of America v. U.S.*, 341 U.S. 412, 415 (1951) ("courts should not overrule an administrative decision merely because they disagree with its wisdom.")

Two procedural questions remain before we reach the merits. The statute is silent as to which party shall bear the burden of proof in a suit challenging the agency's *ex parte* seizure and by what quantum of evidence that proof shall be established. On this point, plaintiff argues that the FHLBB has the burden of showing that its decision was reasonable in light of the facts. Summary of Pltf.'s Response to Def.'s Summary Judgment Motion, 10-11. We disagree. The general rule regarding burden of proof in actions challenging agency action is that the burden of proving error is on the party contesting the validity of the action. *Pacific States Co. v. White*, 296 U.S. 176 (1935). Where the agency action pursuant to a notice and hearing procedure, the presumption of validity is especially warranted. *Id.* at 216. Nonetheless, even where the agency acted *ex parte*, its decision is still entitled to a presumption of correctness, albeit a lesser one. *New Hampshire Fire Insurance Co. v. Murray*, 105 F.2d 212, 217-218 (7th Cir. 1939). The presumption accorded *ex parte* action is one of "prima facie correctness"); *but see U.S. v. Maxwell*, 278 F.2d 206 (8th Cir. 1960). This view is confirmed by the more recent case of *Citizens to Preserve Overton Park v. Volpe*, *supra*. In that case, the government agency acted without a hearing and without stating findings; the Court held that while the agency's action was subject to a "probing in depth review," nevertheless, "the Secretary's decision is entitled to a presumption of regularity." 401 U.S. at 415-416.

The burden is thus on the challenger, Telegraph, to overcome that presumption.[9] But because the presumption is only slightly in favor of the FHLBB, plaintiff need not go so far as to show the agency's decision was arbitrary or capricious; plaintiff need only show that the decision was incorrect by the greater weight of the evidence. This conclusion is supported by the provisions in the Administrative Procedure Act, 5 U.S.C. § 706(2)(F) relating to *de novo* trials. Section 706(2)(F) provides that a reviewing court shall

> (2) hold unlawful and set aside agency action findings, and conclusions found to be—
>
> * * * * *
>
> (F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

Although our proceedings in this case are not governed by the provisions of 5 U.S.C. § 706(2)(F), but by 12 U.S.C. § 1464(d)(6)(A), *see Forester v. Consumer Products Safety Commission*, 559 F.2d 774 n. 22 (D.C. Cir. 1977), the comparison is instructive. In other contexts in which a trial *de novo* is considered appropriate, the Congressional preference is for a decision based on whether the agency action is supported by the facts.

Lastly, we note that the statute as it existed prior to 1966 provided that the Board's determination that a receivership was justified should be "subject to review . . . by the court . . . upon the weight of the evidence."[10] It

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[9] A different result would obtain if this action were brought by the agency to enforce its own ruling. In such a case, the agency acts in the role of prosecutor and is given the prosecutor's burden. U.S. v. International Harvester Co., 387 F. Supp. 1338 (D.C.D.C. 1974). Section 1464(d) provides a different scheme. Under the statute, agency action is not tested through an enforcement proceeding but through suit instituted by the association.

[10] *See* former 12 U.S.C. § 1464(d)(2); *see, e.g.*, Beacon Federal Savings & Loan Association v. FHLBB, 162 F. Supp. 350 (E.D. Wis. 1958).

does not appear to us that in revising this statute, Congress intended to impose a heavier burden of proof on an association than existed under the old statute.

We now turn to the merits and consider whether, on the weight of the evidence, the three prerequisites for the appointment of a receiver existed.

It must first be determined whether "an insured institution . . . has been closed by or under the laws of any state." Plaintiff argues that this condition was not met here since although Telegraph was closed by state officials, it was not closed in compliance with state law. According to Illinois law, unless an emergency exists, the state must give notice to the savings and loan association prior to taking custody of its business. Ill. Rev. Stat. ch. 32, § 848. In closing Telegraph, the Commissioner claimed that an emergency existed and gave no notice. Plaintiff disputes the existence of an emergency and contends that since notice was not given, the institution was not closed "by or under the laws of" Illinois.

The legislative history of § 1729 leads us to a different conclusion.[11] Prior to the Bank Protection Act of 1968, which enacted § 1729(c)(2), when a state took custody of a federally insured state savings and loan association, the state was free to appoint its own receiver or to delegate the task to the FSLIC. Although the FSLIC usually absorbed upwards of 95 per cent of a failing association's liabilities, it was seldom appointed receiver. Between 1941 and 1968, only five associations in the nation went into receivership. The FSLIC, while primarily liable on the claims against these institutions, was given control over none of the assets. In one case involving the failure of Marshall Savings & Loan Association, the state receiver accepted FSLIC insurance money but refused to provide the corporation with any financial records. When the records were provided several years later, it became apparent that Marshall's assets had been allowed to de-

[11] See note 7.

teriorate. The Senate Report on the Bank Protection Act described the problem:

> Thus, under the information blackout, the Marshall receivership tied up $83 million of the FSLIC's capital for 3 years at an interest cost of $12 million; it increased the insolvency of the association by more than $4 million; and it failed to pay back a single penny to the FSLIC for its insurance payments or for interest on its capital. Unfortunately, under existing law, except for its claim for interest in the use of funds, the Home Loan Bank Board and the FSLIC were completely powerless to deal with the situation. Unlike Federal associations, the Home Loan Bank Board could not appoint the FSLIC as receiver to safeguard the association's assets and to effect an orderly liquidation.

S. Rep. No. 1263, 90th Cong., 2d Sess. *reprinted in* 1968 U.S. Code Cong. & Ad. News 2530, 2537. Legislation allowing the FHLBB to appoint the FSLIC as receiver whenever a state takes custody of an insured institution was finally introduced when two other Illinois receiverships threatened to repeat the Marshall situation. *Id.* at 2537.

Section 1729(c)(2) was thus intended to protect the funds of the FSLIC from dissipation in the hands of a state receiver. In view of this purpose, the legality of the receivership under state law is hardly relevant to FSLIC's authority to take charge of the assets of a defunct association. Whenever a state savings and loan association is closed, FSLIC's funds are put at risk. The FSLIC would be in no better position if its funds were depleted by a receiver who took possession in accordance with, rather than in violation of, state law.

The legislative history reveals another reason why plaintiffs' argument cannot be accepted. The Senate Report notes that "the effect of the legislation would be to enable the FSLIC to defend its appointment under Federal law instead of requiring it to defend the legality of the State savings and loan administrator's determi-

nations under state law." *Id.* at 2540. To require the FHLBB to show that Telegraph was taken into custody in compliance with Illinois law would undermine the Congressional intent to have the federal agencies' conduct evaluated under uniform federal law.

We therefore conclude that the first requirement of § 1729(c) is met whenever an institution is closed by state officials.[12] Since it is undisputed that Telegraph was closed by state officials on May 22, 1980, the first requirement of § 1729(c)(2) was satisfied.

The second requirement is that one or more grounds specified in § 1464(d)(6)(A) exist at the time the association passes into receivership. Defendants argue that at the time the FSLIC took over, Telegraph was both insolvent and in an unsafe and unsound condition to transact business.[13] We turn first to evidence of Telegraph's

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[12] We think the intent of the language "by or under the laws of any state" is similar to that of the phrase "under color of" state law which appears in 42 U.S.C. § 1983. The Supreme Court has interpreted the latter phrase to include not only action performed in conformity with state law but also action "made possible only because the wrongdoer is clothed with the authority of state law." Monroe v. Pape, 365 U.S. 167, 184 (1960).

[13] The Board cited the following reasons for its appointment of FSLIC as receiver:

> Telegraph is in an unsafe and unsound condition to transact business in that the association's losses have placed Telegraph in a condition of insolvency or immanent insolvency.

Complaint, Ex. B. Plaintiff contends that in view of this statement, the Board moved against Telegraph only under the "unsafe and unsound" provision of § 1464(d)(6)(A). Since an agency's action can only be upheld on the basis that was articulated by the agency itself, and not on the basis of post-hoc rationalizations, S.E.C. v. Chenery Corporation, 332 U.S. 194 (1947), plaintiff objects to the Board's attempt to justify its conduct under both the "unsafe and unsound" provision and the "insolvency" provision of § 1464. We think, however, that the Board's statement expressed its intent to proceed against Telegraph under both provisions of the statute. Moreover, the

(Footnote continued on following page)

insolvency as of May 22, 1980. It is undisputed that from July 1, 1979, to April 30, 1980, Telegraph's net worth steadily declined from nearly $5 million to $450,000.00 and that the operational losses for April alone exceeded $734,000.00. On May 19, Telegraph's comptroller made the following projection:

> Based upon my review of the books and records of Telegraph as of May 19, 1980 and taking into consideration my knowledge of the financial circumstances of Telegraph, I estimated that for the period of May 1 through 19, 1980, Telegraph had lost $591,778.29 and I projected that for the entire month of May, Telegraph would lose $983,147.86.

Conover Affid., ¶3 (8-26-80). On the basis of the comptroller's projections, Telegraph had a negative net worth of approximately $142,000.00 on May 19 and of approximately $240,000.00 on May 22. Based on April's losses, Telegraph's treasurer also estimated that the Association had a negative net worth of $89,000.00 as of May 22, 1980. Seeley Affid. ¶5 (8-26-80).

Plaintiff challenges these figures as speculative. Telegraph points out that it kept its books on an accrual basis and that under this system, its net worth could not have been calculated until the end of the month and would not have been available until the Association filed its report with the FHLBB on June 10, 1980. Plaintiff's expert Dr. Sherman Shapiro concludes that "any intra-monthly calculation or quantification of Telegraph's net worth

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[13] *continued*
rule prohibiting *post hoc* rationalizations is intended to "avoid propel[ling] the court into the domain which Congress has set aside exclusively for the administrative agency." *Id.* at 196. In the instant case, evaluation of the Board's decision under the "insolvency" provision of § 1464(d)(6)(A) will not constitute an invasion of the FHLBB's turf. In justifying the receivership, the agency expressly stated that insolvency was Telegraph's central problem. That the wording of the Board's statement did not systematically reflect the categories set forth in the statute does not obscure the substance of the Board's findings.

such as was attempted on May 22, 1980, would be extremely tentative and subject to wide variances." Shapiro Affid., ¶33 (4-10-81). Shapiro even questions the accuracy of the net worth figures appearing in the monthly reports. He states that, "The first truly accurate calculation of Telegraph's net worth would not have been available until the annual audit as of June 30, 1980, in view of the necessary adjustments, frequently substantial, that are customarily made in connection with such audits." *Id.* at ¶34.

While we understand Dr. Shapiro's concern for obtaining the most accurate assessment of Telegraph's position, we do not believe that Congress intended that the FHLBB await the issuance of a failing association's annual audit (which may be months away) or even the issuance of its monthly statement (which may be weeks away) before appointing a receiver under § 1464(d)(6)(A)(i). The insolvency requirement must be read in light of the purpose of the Bank Protection Act of 1968 to safeguard the financial integrity of the FSLIC. That purpose would be seriously undermined if § 1464(d)(6)(A)(i) were read to require the FHLBB to wait weeks or months—while the association's liabilities, and, thereby, the FSLIC's obligations, increase—before exercising its statutory authority to take custody of a business which is projected to have a substantial and growing negative net worth.

In our view, plaintiff's argument goes too far. Its position is that projections of net worth are *per se* an unreasonable basis for the Board's exercise of its power. As the foregoing discussion indicates, we think the Board is entitled to rely on projections of net worth, provided they are reasonable. There is a strong argument that the net worth estimates upon which the Board relied here were reasonable. The projections were entirely in keeping with the Association's performance for the month of April and for the prior ten months. Moreover, according to Telegraph's treasurer, there were no indications that May would show improved performance. Seeley Affid., ¶4 (8-26-80). Additionally, the projections were made by apparently reliable sources of information con-

cerning Telegraph's financial status, namely its treasurer and its comptroller. Plaintiff contends that notwithstanding these indices of reliability, "there was no reasonable basis upon which a finding of insolvency or imminent insolvency could have been made." Shapiro Affid., ¶31 (4-9-81).

While at first blush the projections appear to have been reasonable, Dr. Shapiro's affidavit has put this factual issue squarely in dispute. Therefore, it can only be resolved at trial.

As noted above, the Board also exercised its powers of appointment on the ground that Telegraph was in an "unsafe and unsound condition to transact business." In the court's view, deciding whether Telegraph was in an unsafe and unsound condition is considerably more complex than deciding whether the institution was insolvent. For this reason, we will defer consideration of the "unsafe and unsound" issue pending our decision on the insolvency issue.

The final requirement under § 1729(C)(2) is that "one or more of the holders of withdrawable accounts in such institution is unable to obtain a withdrawal of his account in whole or in part." In the instant case, the FHLBB sought to satisfy this requirement in the following manner. Immediately after the state officials closed the institution, the Board requested one of its employees, who was a depositor at Telegraph, to attempt to withdraw $25.00. Since the bank had been closed, the demand was refused. The "disgruntled" depositor was, on the spot, presented with an affidavit memorializing the bank's refusal, which he signed. Plaintiff argues that the third requirement of § 1729(c) was intended to limit FSLIC receiverships to those cases in which an association does not in fact have sufficient liquidity to meet depositors' demands. At the time the $25.00 demand was made, Telegraph had over $11 million in liquidity. Shapiro Affid. ¶9 (4-8-81). Plaintiff contends that by seeking to satisfy the requirement through a bit of play acting, the Board renders it meaningless. The Board responds that once an association is closed under state law, depositors *ipso facto*

cannot withdraw their funds. The language of the statute, they say, makes no distinction between situations in which demands are made by lines of panicked depositors and those in which a demand is made by a person acting at the behest of the Board.[14]

While the playlet directed by the Board in this case borders on the farcical, the fault is not with the director but with the script, i.e., the statute. Section 1729(c)(2) proposes three *conjunctive* requirements for the appointment of the FSLIC as receiver. A cursory examination of these requirements reveals that the third requirement (that a depositor be unable to withdraw funds) cannot be given meaning independent of the first (that the association be closed under state law): Once an association is closed, no depositor can get his money. We are aware of the canon of statutory construction which provides that a statute should be construed so as to give effect to all its parts. *General Motors Acceptance Corp. v. Whisnaut*, 387 F.2d 774 (5th Cir. 1968). But with respect to § 1729(c)(2), plaintiffs have shown us no way in which we could interpret the third requirement to give it independent meaning. Plaintiff only states that it should be construed to apply exclusively to the case in which an association is subject to a genuine run on its deposits. Plaintiffs fail to realize that such a run is impossible after an association has already closed its doors.

We therefore find that the third requirement was met after Telegraph was closed and a demand was refused.

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[14] The Board also justifies the use of its own agent to satisfy the third requirement of the statute by the desire to prevent panic among the depositors. The Board points out that plaintiff's argument that an institution may be closed only when it genuinely does not have sufficient cash on hand to pay depositors suggests that conditions conducive to panic must exist before the Board is empowered to act. However, in view of the purpose of § 1464 and § 1729 to preserve public confidence, Sen. Report No. 1263, *supra* at 2536, it would be odd indeed if the Board were required to stay its hand until the crowds were at the association's doors.

SUMMARY

With respect to Count III, we find a genuine issue of material fact on one issue only: the reasonableness of the net worth projections upon which the Board relied in appointing the FSLIC receiver. A trial will be held on this issue. Should plaintiff fail to show by the greater weight of the evidence that the projections were not reasonable, judgment on Count III will be entered in favor of defendants. If, however, the court finds that the projections were unreasonable, it will consider in further proceedings whether any other conditions listed in 12 U.S.C. § 1464(d)(6)(A) existed at the time Telegraph was closed.

The parties are requested to appear at 9:45 a.m. on June 16, 1981, for the purpose of setting a trial date.

DATED: June 9, 1981

ENTER: /s/ JOHN F. GRADY
United States District Judge

APPENDIX H

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 83 C 757

MANNING SAVINGS AND LOAN ASSOCIATION,

Plaintiff,

v.

FEDERAL SAVINGS AND LOAN INSURANCE CORP., FEDERAL HOME LOAN BANK BOARD, BREACT H. BEESLEY, FSLIC Director, ROBERT PATTULO, JOHN CAIN, JOHN SEARS, RICHARD PRATT, EDWIN GRAY, JAMIE JACKSON, and PAUL I. DOWNING,

Defendants.

MEMORANDUM OPINION

Prentice H. Marshall, District Judge

Plaintiff Manning Savings and Loan Association ("Manning") is a savings and loan association chartered under the laws of the state of Illinois. This action arises out of the takeover of Manning in February 1983 by the Federal Home Loan Bank Board ("Bank Board") due to insolvency and unsafe and unsound banking practices. Manning's amended complaint names as defendant the Bank Board; the Federal Savings and Loan Insurance Corporation ("FSLIC"), which the Bank Board appointed as receiver for Manning; three FSLIC employees involved in the

receivership, Robert Pattulo, John Cain and John Sears; three members of the Bank Board, Richard T. Pratt, Edwin Gray, and Jamie J. Jackson; H. Brent Beesley, FSLIC director (misnamed in the caption as "Breact H. Beesley"); and Paul I. Downing, Savings and Loan Commissioner for the State of Illinois.

Plaintiff's amended complaint is stated in five counts. In count 1, plaintiff alleges that the Bank Board unlawfully appointed the FSLIC as receiver and that the appointment deprived Manning of property without due process of law. In count 2, plaintiff alleges that the Bank Board effected the takeover of Manning based on findings by defendant Downing that an emergency existed, permitting the Bank Board to act without prior notice to Manning's directors. Manning alleges that Downing acted in violation of Illinois law and deprived Manning of property without due process of law. In count 3, plaintiff asserts that all defendants acted individually and in concert to violate Manning's constitutional rights. Count 4 purports to state a claim that the federal statutes under which the Bank Board acted are unconstitutional as violative of due process and the tenth amendment to the Constitution. Finally, in count 5 plaintiff asserts that defendants' acts constituted an unlawful conversion of Manning's assets. Plaintiff seeks a declaratory judgment that defendants' conduct and the governing federal statutes are unconstitutional; an injunction removing the FSLIC as receiver of Manning; an award of damages; and an accounting with respect to any assets of Manning sold by the FSLIC.

Defendant Downing has moved to dismiss all claims against him for failure to state a claim upon which relief may be granted. Fed. R. Civ. P. 12(b)(6). Downing's principal argument is that Manning lacks the capacity to maintain any claim against him. As will be seen, this permits us to dispose of most of Manning's claims.

The Bank Board acted pursuant to 12 U.S.C. §1729(c)(1)(B)(i)(1) (West Supp. 1983), which provides that if the Bank Board determines that any of the grounds specified

in *id.* §1464(d)(6)(A)(i-iii) (Supp. V 1981) exist, it has the authority to appoint the FSLIC as sole conservator and receiver of any savings and loan association the deposits of which are insured by the FSLIC. Under §1464(d)(6)(A)(i-iii), the grounds for appointment of a receiver include: (i) insolvency in that the association's assets are less than its obligations to creditors and others; (ii) substantial dissipation of assets or earnings due to violations of law, rules, or regulations, or to any "unsafe or unsound" practice(s); and (iii) "an unsafe or unsound condition to transact business." Under the statute, if the Board is of the opinion that a ground for appointment of a receiver exists, it may act without notice to the institution. That is what the Bank Board did here.

Defendant Downing's statutory role in the takeover is spelled out in §1729(c)(1)(B)(i)(II):

> The authority conferred [on the Bank Board] by [§1729(c)] shall not be exercised without the written approval of the State official having jurisdiction over the State-chartered institution that the grounds specified for exercise exist.

Thus, as a precondition for the Bank Board's takeover of Manning and appointment of the FSLIC as receiver, Downing was required to give and in fact gave written approval that grounds existed under §1464(d)(6)(A) for the takeover.

Downing argues that Manning's sole remedy to challenge the takeover and receivership is an action under §1464(d)(6)(A). That statute provides as follows:

> In the event of . . . appointment [of a receiver], the [savings and loan] association may, within thirty days thereafter, bring an action in the United States district court for the judicial district in which the home office of such association is located . . . for an order requiring the [Bank] Board to remove such . . . receiver, and the court shall upon the merits dismiss such action or direct the Board to remove such conservator or receiver.

To support his argument that §1464(d)(6)(A) is the exclusive remedy for Manning, Downing directs our attention to §1464(d)(6)(C), which provides that

> [e]xcept as otherwise provided in this section, no court may take any action for or toward the removal of any conservator or receiver, or, except at the instance of the [Bank] Board, restrain or affect the exercise of powers or functions of a conservator or receiver.

Downing cannot rely solely upon §1464(d)(6)(C), however, for it is not self-evident that an action for damages against the Bank Board, the FSLIC, Downing, and agents of the Bank Board and FSLIC would require us to "take any action for or toward the removal" of the FSLIC as receiver of Manning. Thus, Downing's exclusivity of remedy argument is coupled with an assertion that Manning lacks the capacity to maintain any action other than that permitted by §1464(d)(6)(A), since upon the appointment of the receiver Manning lost title to all of its assets, including choses in action such as legal claims.

We address Manning's injunctive relief claims first. The plain language of §1464(d)(6)(C) prohibits any action for injunctive relief other than an action under §1464(d)(6)(A) to require the Bank Board to remove the receiver. Each of Manning's injunctive relief claims is phrased at least partly in constitutional terms, and only count 1 expressly relies on §1464. Manning cannot, consistent with §1464 (d)(6)(C), maintain a claim under 42 U.S.C. §1983 (Supp. IV 1980) in which it seeks to remove the FSLIC as receiver or to require the Bank Board to do so.

However, we do not see any barrier to Manning asserting its constitutional claims as a basis for removal of the receiver under §1464(d)(6)(A). In *Fidelity Savings and Loan Ass'n v. Federal Home Loan Bank Board*, 689 F. 2d 803 (9th Cir. 1982), *cert. denied*, 103 S. Ct. 1893 (1983), the plaintiff asserted procedural due process claims as a basis for removing a receiver under §1464(d)(6)(A). Defendant has not cited any authority limiting an association

suing under §1464(d)(6)(A) to an argument that grounds for a takeover did not exist, nor have we found any. Manning is entitled to argue, as a basis for an action under §1464(d)(6)(A), that the takeover was accomplished through a violation of due process and that the statutes authorizing the takeover themselves are violative of due process.[1]

As far as damage claims are concerned, when the FSLIC was appointed receiver of Manning, it stepped into the shoes of the institution and acquired title to all its assets. Under 12 U.S.C. §1729(d) (West Supp. 1983), when it was appointed receiver of Manning the FSLIC acquired the power to carry on Manning's business and to do everything necessary to that end. The regulations promulgated under §1729(d) provide that the receiver has the authority to exercise all the rights and powers of the savings and loan and to represent the institution in any legal action brought by or against it. *See* 12 C.F.R. §596a.6 (a)(2-3) (1983). In *First Savings and Loan Ass'n v. First Federal Savings and Loan Ass'n*, 531 F. Supp. 251, 255-56 (D. Hawaii 1981) ("*First Savings I*"), the court relied on these provisions and on general receivership law to conclude that a savings and loan for which a receiver has been appointed loses the power to maintain any lawsuit other than the action expressly authorized by §1464(d)(6)(A). *See also First Savings and Loan Ass'n v. First Federal Savings and Loan Ass'n*, 547 F. Supp. 988, 994 (D. Hawaii 1982) ("*First Savings II*").

Under receivership law, a statutory receiver obtains title to the assets of the institution in receivership. *See, e.g., First Savings I*, 531 F. Supp. at 255; *People ex rel.*

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[1] We have serious doubts, however, as to the merits of any procedural due process claim by Manning, particularly in light of Fahey v. Mallonee, 332 U.S. 245, 253-54 (1947), in which the Supreme Court held that a similar statute that permitted takeover of a bank without prior notice and hearing did not violate due process. *See also, e.g.*, Fidelity Savings and Loan Ass'n v. Federal Home Loan Bank Board, 689 F. 2d 803, 811, 814 (9th Cir. 1982), *cert. denied*, 103 S. Ct. 1893 (1983).

Palmer v. Peoria Life Insurance Co., 376 Ill. 517, 34 N.E. 2d 829, *cert. denied sub nom. Harwick v. O'Hern*, 314 U.S. 688 (1941); *Lanigan v. Apollo Savings*, 30 Ill. App. 3d 781, 332 N.E. 2d 591 (1975). The same principles have been applied to bank receiverships. *See, e.g., First Savings I*, 531 F. Supp. at 255-56; *Landy v. FDIC*, 486 F. 2d 139, 147 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974); *FDIC v. American Bank Trust Shares, Inc.*, 412 F. Supp. 302, 306 (D.S.C. 1976), *vacated on other grounds*, 558 F. 2d 711 (4th Cir. 1977). Manning thus cannot maintain a lawsuit, except of course for an action under §1464 (d)(6)(A) for removal of the receiver. If Manning succeeds in obtaining an order removing the FSLIC as receiver, it will then be able to maintain its damages claims, unless they are barred by collateral estoppel as a result of decisions reached in adjudicating the §1464(d)(6)(A) claim.

We have held that plaintiff may proceed only with its action to remove the FSLIC as receiver under §1464(d)(6)(A). Under that statute, the only relief we may grant plaintiff is an order directing the Bank Board to remove the FSLIC as receiver. It follows that none of the other defendants are proper parties to this action.[2] Indeed, the Bank Board is the only defendant named in count 1, plaintiff's §1464(d)(6)(A) claim.

While count 1 of plaintiff's amended complaint is pleaded in part in terms of §1464(d)(6)(A), it also contains claims under 42 U.S.C. §1983. The only part of count 1 that may remain is plaintiff's §1464(d)(6)(A) claim. The remainder of count 1, as well as counts 2 through 5, are dismissed due to the exclusivity of §1464(d)(6)(A) and plaintiff's lack of capacity to maintain any action other than a §1464(d)(6)(A) action.[3] All defendants except the Federal Home

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[2] The individual federal defendants have moved for dismissal under Fed. R. Civ. P. 12(b)(6).

[3] Count 2 purports to arise under 17 Ill. Rev. Stat. §3191 (1981). That statute governs defendant Downing's power to take custody of the assets of savings and loans. Since Downing did not take custody of Manning, §3191 has no application here.

Loan Bank Board are dismissed. The Bank Board is to answer within 14 days of entry of this order. Prior discovery/trial schedule to stand.

ENTER:

/s/ Prentice H. Marshall
District Judge

DATED: September 14, 1983.